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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Thursday, the 31st day of October, 1963.

COMMISSION:

MR. KENNETH LeM. CARTER -- Chairman

MR. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

MRS. S.M. MILNE

MR. CHARLES WALLS

COMMISSION COUNSEL:

MR. J.L. STEWART, Q. C.

MR. J. M. COYNE

RESEARCH DIRECTOR:

PROF. D.G. HARTLE

SECRETARY:

MR. G.L. BENNETT

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/MR/RPS

---ON COMMENCING AT 9:30 A.M.

THE CHAIRMAN: Mr. Secretary it is virtually 9:30. I think we will start.

THE SECRETARY: Mr. Chairman, Commissioners, this morning we have before us the Trust Companies Association of Canada who are submitting a brief which was received in our office on October 7th 1963. Mr. J.M. Wells, President of the Association, President of the Royal Trust Company will give a few introductory remarks and will then introduce his colleagues.

To mark the occasion, I might add, Mr. Chairman, it is Mr. Ed Nelson's birthday. He is the Executive Director of the Association. The 29th he tells me.

THE CHAIRMAN: We will be very nice to him.

THE SECRETARY: I would like to enter this brief into the record as Exhibit 240.

---EXHIBIT NO. 240: Submission of the Trust Companies Association of Canada.

SUBMISSION OF

THE TRUST COMPANIES ASSOCIATION OF

CANADA

Appearances:	Mr. J.M. Wells	Mr. J.K. Allison
	Mr. K. Burn	Mr. J.M. Smith
	Mr. E.F.K. Nelson	Mr. J.E. Ford

THE CHAIRMAN: Good morning Mr. Wells, gentlemen.

MR. WELLS: Good morning sir.

THE CHAIRMAN: Let me introduce to you, first of all, the Commissioners before you introduce your associates to us. The names are all here. I don't need to repeat them. We are very glad to see you indeed. It is nice of you to come and see us. We have read your submission with a great deal of interest. Thank you very much for it.

Now if you care to introduce your associates to us, we would appreciate it.

MR. WELLS: Thank you Mr. Chairman, Commissioners. On my immediate left is Mr. Ken Burn, General Manager of the Chartered Trust Company and Chairman of the Committee that was responsible for our brief.

On my right is Mr. J.K. Allison, Supervisor of personal trusts,Montreal Trust Company who worked very closely with Mr. Burn on the preparation of this brief.

On my far left is Mr. J. Eric Ford of Clarkson Gordon and Company, Toronto, and Mr. John Smith of Woods Gordon and Company who are here as advisers to the Association.

On my right is Mr. E.F.K. Nelson, Executive-Director of the Association.

On behalf of the Association I can say we are very glad of the opportunity to submit this brief. We have a very lively appreciation of the importance of the study that your Commission has undertaken and we sincerely hope that the material that we have supplied

you with will be of some assistance to you in your deliberations.

I think all I need say further is that we are here to answer, to the best of our ability, any questions that you may wish to direct to us and with your permission, I would ask you to recognize Mr. Ken Burn as our main speaker. Thank you.

THE CHAIRMAN: Thank you Mr. Wells. Don't bother standing from now on unless you wish to do so. We try to conduct these things reasonably informally, consistent, of course, with getting a proper record of proceedings.

Now in view of the importance of this submission, and the care we wish to give to it, we have asked our legal counsel, Mr. Coyne, to be so kind as to lead the questioning today. It will not exclude us, as you may find out. Mr. Coyne will start off and we may interrupt him from time to time. This submission I think, Mr. Coyne, lends itself to taking it part by part. Am I correct?

MR. COYNE: That is what I intended, Mr. Chairman.

THE CHAIRMAN: At the end of each part, it might be well for you to pause, if you would, and see if there are any questions from up here.

MR. COYNE: Very good.

THE CHAIRMAN: Does that suit you?

MR. COYNE: Yes. Shall I proceed Mr. Chairman?

THE CHAIRMAN: You may proceed then.

MR. COYNE: Well Mr. Burn I guess I should direct my questions to you, as Mr. Wells has suggested, although, of course, it is open to any of your associates as they see fit to answer in whole or in part any question, or take part in the discussion which may arise out of the questions.

First, by way of introduction, it is sometimes helpful to the Commission, in the case of briefs from Associations such as yours, to have a brief outline as to the manner in which the brief was prepared. That is, whether it was prepared by an individual or a Committee. Whether there was an opportunity to submit it for general discussion to the membership, and that sort of thing. Can you briefly describe for us, in a general way, the manner in which you prepared your brief?

MR. BURN: Mr. Chairman, it occurred to me that one of these days I might find something sufficiently iniquitous in our taxation legislation that I may be appearing before the Exchequer Court so I will practice my standing, if you don't mind.

We took the basic material, which was forwarded to us by the Commission, and circulated it to our member companies and asked each company to nominate a person who could express the primary opinions of the company and who had some aptitude in this line of work.

We also asked each company to let us know any particular matters which they felt should be included in the brief and we assembled that material and we also distributed the general questions, and the questions

of particular reference to trust companies. From the preliminary material I did the basic drafting and we only had one general meeting. Because of our geographic distribution, it was somewhat difficult to gather everyone together at one time, although we had quite a number of meetings in the City of Montreal and in the City of Toronto of smaller groups who were identified.

Certain matters which were beyond our research facilities, we engaged the help of these gentlemen, and I might say that we discarded more material, I think, than we have included in the brief. When the matters were in reasonably good form, we again distributed them to the members of the Association and asked for any comments and then the brief, in practically its final form, was submitted to the Executive Committee of the trust companies who, subject to a few minor revisions, gave it the stamp of approval as it is now before you.

MR. COYNE: It is a fair assumption that the brief represents a broad concensus of the views of the trust companies who are your members? It does not assume everyone of them agrees with every particular point, necessarily?

MR. WELLS: That is right. I think it might be said the Executive Commitee of the trust company was advised by the company-heads of the member companies. I cannot say that there were all at the meeting. There was a very fair representation.

MR. COYNE: Turning, if we may, to the substance of the brief itself, and in particular to the

"first part which is the recommendations with respect to the taxation of trust companies, your first recommendation, and I read it from paragraph 1.07 is as follows:

"1) The Income Tax Act should be amended "to permit trust companies to include in "income only the interest portion of rental "payments under leaseback investments and the "portion of the rental payment which is a "return of the capital investment should "be allowed as a deduction from gross rental "for the purposes of computing taxable income."

Now I suppose that the first question I might ask you in this connection is what do you mean by the word "leaseback" in this context? Could you give us your understanding of what you are speaking of as "leaseback"?

MR. BURN: Well I believe the term, generally used, is when you are primarily dealing with a parcel of real estate which is customarily of relatively high value. Very often the building is built to the specification and design of the ultimate occupant who does not necessarily wish to be the owner of the real estate. It is usually leased under conditions of the relatively long term and as far as we are concerned, under our Federal governing statute the tenant might meet very rigid qualifications as to his financial stability. The lease is usually of the form where there is a net return to the owner and the variable carrying charges are met by the tenant, or occupant.

MR. COYNE: Does it necessarily involve an

option of the lessee to purchase the property at the end of the lease?

MR. BURN: Not necessarily. As a matter of fact, prior to the amendment which was introduced into the Act this year, which wiped out the provisions of the Section which escapes my mind at the moment, it was invariably the case that there would not be, as far as our experience is concerned, there was not an option to purchase, although very frequently there is the option to extend the term of the lease. Let us suppose the primary term is 25 years, there might be two or three options of reasonable periods of five-year terms where the rent is generally at considerable lesser rate because it is accepted that the capital cost has been written off during that period.

MR. COYNE: Am I correct in thinking that your recommendation in this connection relates to leasebacks as you have described them, whether or not there might be an option to purchase included in the arrangement?

MR. BURN: Yes, that would be so.

MR. COYNE: Just picking up, if we may, the section of your brief which really starts at page 9 and goes on, where you develop your reasons for making this recommendation, you point out that the legislation governing trust companies, and you take as an example the Federal Statute, permits such companies to invest in real property for income purposes, I think the term is in the Statute, although I am not familiar with it, provided that the investment yields a reasonable interest return, plus the repayment of at least 85 per cent of the

amount invested over the term of the lease, not being more than 30 years, and then you go on, and I am looking at page 10 paragraph 2.04 to state:

"In practice the prudent investor "attempts to recover the cost of the invest- "ment in a somewhat shorter period."

And you have a very interesting example here, which you expand upon which shows the return of one hundred per cent of the investment over a 25-year term.

Now is it your recommendation that the Income Tax Act should be amended to permit trust companies to write off the capital because of these investments, in accordance with the limits prescribed in the Trust Company Legislation, or in accordance with the standards of a prudent investor as indicated in your example?

MR. BURN: Well Mr. Coyne as I understand the provisions of the Trust Company Act, that is a minimum provision, the 85 per cent. As I understand common business practice, this is what we have outlined in our brief. In a sense, of course, it depends upon the internal accounting which the owner of the property does in his own record but from a competitive position, I know that these are quoted on the basis of a percentage rate which will, that is a gross percentage rate which will fully depreciate the building over a term of the lease, and 25 is the rather customary term, 25 or 30, but I think the preponderance is 25 years, and so it would be our recommendation that we could write off, in accordance with, quite frankly, the intent in which

we entered into the contract.

MR. COYNE: In other words, the investor, or the owner of the property, in your submission, should be entitled to write off the cost of the investment over whatever term the particular arrangements call for?

MR. BURN: Yes. It would not be unreasonable to have a minimum term. I am not suggesting it be five years for example. I don't know whether you were going to suggest it or not.

MR. COYNE: No. I am just really exploring, Mr. Burn.

MR. BURN: May I say that with the limitations that are found on the type of company with whom we can enter into this arrangement, I don't think that you would find any such company willing to enter into an unbalanced form of agreement which could lead to abuses.

MR. COYNE: Yes, I understand. The only thing that perhaps is not quite clear, at least to me, is that you appear to justify this recommendation on the grounds that the trust company legislation imposes certain limitations upon you but then, as I understand you, doesn't the trust company legislation rule that you want incorporated in the Income Tax Act, you really want to be permitted to write these costs off on a prudent investor standard, if you like which, within certain limits, is within the choice of the company itself?

MR. BURN: Well I think we are on common ground when we appreciate that the trust company legislation is for a very specific purpose, in order to protect the integrity of the investor.

MR. COYNE: Would it be fair, I don't want to interrupt you, but would it be fair to say that the trust company legislation is there for the purpose of imposing, if that should be necessary, certain minimum prudent investor standards on the companies?

MR. BURN: That is correct. May I say that our submission primarily arises from the fact that we believe that we are not in a competitive position in this field. We are the obvious source of providing this source of funds for development in Canada. That is the basis of our recommendation, but we cannot enter into the market competitively. I would be quite happy to accept the 85 per cent limitation if in fact it was not recommended one hundred per cent but, as I say, these companies which are in a non-taxable position, as far as this particular item is concerned, or pension trusts, which are not taxable enter into these contracts, on the basis of my experience -- I don't know whether it agrees with yours Ken -- on a full amortization over the term of the loan of 25 to 30 years.

MR. COYNE: Yes, because in the case of pension trusts the taxes are not a consideration anyway, and in the case of insurance companies there is another and difference method of computing their income. Even leaving those types of institutions aside, there are indeed other taxpayers in the country who are dealing in leasebacks, other taxpayers both corporate and individual.

MR. BURN: That is so. My experience with individuals is limited. I have run across them in cases

where perhaps they do not qualify, the tenant does not qualify. In corporations I know of one in particular where they are in the whole sphere of real estate investment.

MR. COYNE: When you say the tenant would not qualify, you mean he would not qualify for a trust company leaseback?

MR. BURN: That is correct.

MR. COYNE: Because of the limitation in the trust company legislation?

MR. BURN: That is right.

/RPS

MR. COYNE: Do you think that we are limiting ourselves to consideration of those tenants, if you like, who do qualify within the trust company limitations? Is it your recommendation that the procedure you suggest here be only available to trust companies or would it not in equity have to be available to other prudent investors who wish to write off the capital cost of such?

MR. BURN: In one section of our brief we say we don't ask for any advantage that is not available to any of our competitors. It would have to be available to anyone just the same as mortgage reserves are available to anyone in the business of holding a mortgage.

MR. COYNE: Let me return to a point you made a moment ago: perhaps I missed it in the brief, we are talking here of only certain types of leasebacks, that is leasebacks which the trust companies are entitled to invest in. I forget what the limitations are.

MR. BURN: Basically it is the corporation that is established whose shares would qualify for investment by an insurance company.

MR. COYNE: So there are dividend limitations and earnings required and that sort of thing?

MR. BURN: Yes.

MR. COYNE: Taking the example that you give as a typical leaseback contract entered into by a trust company, and it appears in tabular form opposite page 10, is not one of the results of your recommendation that trust companies should be permitted to depreciate for tax purposes the cost of land?

MR. BURN: Yes, that is quite so, yes. There is an inherent tax liability in their position. We are obliged to write off the land as well as the building under the legislation governing us.

MR. COYNE: Unless the land is only worth 15 per cent.

MR. BURN: Yes.

MR. COYNE: I am sorry.

MR. BURN: That is quite so. It is a low factor but you could have situations like that.

MR. COYNE: Well now, my question would be if trust companies were to be permitted, in fact, to depreciate for tax purposes the cost of land wouldn't such a provision have to be made of general application?

MR. BURN: Not unless, which is, of course ridiculous, the limitation of investment were made of general application.

MR. COYNE: For this method of treatment we are limited to a relatively narrow sphere of investment.

MR. BURN: Yes.

MR. COYNE: As you suggest.

MR. BURN: Yes.

MR. COYNE: I might put this to you then: a leaseback, of course, is a convenient device, as I understand it for many industrial or commercial concerns who need to have the physical assets but don't want to tie up their own capital. Take a man who for one reason for another is prepared to raise his own capital, but being a prudent investor considers that he should set up in his books depreciation accounts which would

permit him to recover the full cost of his investment in 25 years. Isn't he basically in the same position as you are suggesting that the trust companies are in?

MR. BURN: Mr. Smith -- may I ask, the revenue in one case is taxable income, and in the other case it is just considered prudent as far as the owner is concered -- would you suggest the two were analogous?

MR. FORD: Yes.

MR. BURN: My cdleague says yes.

MR. COYNE: Mr. Ford thinks they would do analogous.

MR. BURN: Yes.

MR. COYNE: It might be implied in your recommendation that really the whole structure of capital cost allowance as we now know it would have to be modified. Would you agree that that is a possible implication?

MR. BURN: May I backtrack just a moment, Mr. Coyne. You suggested that the prudent owner might think it desirable to fully depreciate his asset within 25 years.

MR. COYNE: Yes, I am hypothesism -- really, for the purpose of discussion.

MR. BURN: I have had a chance to do a little second thinking. First of all the purpose of the treatment as placed on us is to protect any third parties. It is to protect the people who deposit their money with us. He is in the realm of a business enterprise and I suggest perhaps there is some little different standard applied. Presently it is open to him at any time -- I don't know

whether I am quite correct in this -- if at any time there is accelerated obsolescence or depreciation on his building and he disposes of it he can claim a tax credit at any stage in his proceedings which results from his disposal of that asset.

MR. COYNE: Yes.

MR. BURN: In our position, for example, we can see a building deteriorating but as long as the tenant is paying rent we can't do anything about it, so perhaps there is something different.

MR. COYNE: The significance being you are tied by the length of the term.

MR. BURN: Yes.

MR. COYNE: Would you tell me, under the present arrangements and taking your example where at the end of 25 years you have fully written off the capital cost of the asset, but you are left with an amount on your books at $210,000, of which $110,000 is undepreciated capital cost of the building and $100,000 is the original cost of the land. What happens at the end of the 25-year period in the case of that kind? The lease has expired and there you are stuck with a building or piece of property has some value.

MR. BURN: Yes. Well, may I say, first of all in consultation with other members of the Association that quite literally we are not in this business in this context. We do it for non-taxable trust so when you ask me what happens there is nothing happening because we are not -- what would happen, may I suggest, is that you would rerent the building and you would start your

depreciation on the basis of your $110,000.

MR. COYNE: That would be a deduction from the income of the subsequent period for tax purposes.

MR. BURN: That is correct.

MR. COYNE: In your proposal the whole amount of the income of the second period would presumably be taxable because you have already written off the capital cost?

MR. BURN: That is right.

MR. COYNE: Including the value of the land.

MR. BURN: Yes, or if there was any disposal of the asset it would be taxable.

MR. COYNE: Yes. In that event where there would be a recapture doesn't your recommendation really amount to a complaint, if you like, of the timing of this tax incidence? I am thinking after all the tax, ultimate income tax is going to be paid on any income that is received over and above the capital cost of the asset leaving aside the matter of land, but under either system ultimately income tax is going to be collected on any excess revenue over and above the cost of the asset?

Isn't it really only a question of timing whether all the tax should be paid earlier or later during the period during which you are deriving revenue from the asset?

MR. BURN: Well,that would be the effect of it, sir, but I suggest that our submission is based quite literally on the fact that if you consider the term reasonable return as being reasonable after taxes we

literally cannot comply with the provisions of the Trust Company Act today and enter into one of these contracts.

MR. COYNE: You, in fact, don't enter into one of these contracts in taxable situations?

MR. BURN: That is right, yes.

MR. COYNE: Well then, I wonder, Mr. Burn unless you or your associates have anything to add if we could pass on to the second point which really involves two recommendations, but I think we could deal with them both together with regard to mortgage reserves.

THE CHAIRMAN: Mr. Coyne, I wonder if it might be a tidier procedure to let us dispose of this first point before we move on to the next point.

MR. COYNE: I think it might be. It is a section in itself.

THE CHAIRMAN: There isn't any relationship between what you are just moving to and what you are talking about now.

MR. COYNE: No.

THE CHAIRMAN: I am sure we have all got questions with regard to this. It would seem to me that the purpose of the introduction of Section 18 whenever it occurred was to prevent the more rapid amortization of buildings where we lease under the conditions and also to prevent amortization of land, so that there wasn't a benefit given to people, to owners of property to enter into these transactions as opposed to those who didn't do so but continued to own property and obtain their money by mortgage. It would seem to me that

your proposal would be tantamount to cancelling Section 18. Am I right? In the example you give it looks to me as if it would have the same result?

MR. BURNS: Mr. Chairman, I would like the backing of my colleagues, but I really understand the intent of Section 18 -- my understanding of it, is perhaps a better way of putting it, the intention behind it wasto prevent a rapid amortization in the hands of persons such as ourselves, and then we would be in a position to sell that to somebody who had also claimed rental as full tax allowance and would be able to still take out our depreciation cost. May I suggest that some ingenious minds found that they could utilize Section 18 to their advantage and as a result it is out of our consideration in future years.

THE CHAIRMAN: Yes. Thank you. Section 18 being now withdrawn, would you not achieve what you are asking for anyhow? Doesn't the withdrawal of Section 18 give you what you are now asking for?

MR. BURN: With respect, sir, Section 18 was applicable to the lessee of the building, was it not, permitted him capital cost allowance on the purchase price?

THE CHAIRMAN: I see, thank you.

COMMISSIONER PERRY: Just a couple of points I would like to make: I think as Mr. Coyne said this lop-sided pattern of allowances is probably common in all industry, particularly if you are relating to the present system of a straight line write off, but most people have found that because they are constantly making

new investments that, in fact, the annual write off is greater than it would be under a straight line system; in other words you never have this deficit at the bottom. I am wondering if that would be your own experience?

Are these leasebacks coming up continually year after year with new arrangements being entered into and the write offs in the earlier years maintaining your aggregate write off at a fairly high level?

MR. BURN: I think as far as market conditions are concerned there is considerable availability and the practice I would suggest is perhaps growing. That may just be in the general growth of the economy. I would direct your attention to the fact that there is a relatively small limitation on the amount which we can invest in those funds, I believe it is one-half of one per cent of our total assets, so we would reach, an ordinary company would reach the maximum in a very short period.

COMMISSIONER PERRY: Well then, I am not too good at arithmetic, but I am confused with the way in which cost of the land works out in this demonstration. It is quite evident that the write offs which appear demonstrate the kind of calculation you would like to take or are required to take including amortization of land and it is equally obvious that you are comparing with that something which does not include amortization of the land. In going to your excess of taxable income column, am I right in assuming this would include the $100,000 representing rental of the land?

MR. BURN: Yes. I believe the first four

columns are the manner in which we are obliged to keep our accounts in this form of investment and the next three columns represent the manner in which we are obliged to account for income tax purposes.

COMMISSIONER PERRY: I am wondering if this isn't--there isn't an implication here that you will be having some allowance made in your tax write offs for the cost of land?

MR. BURN: That is quite so.

COMMISSIONER PERRY: Yes. This is rather unusual, isn't it?

RPS

Isn't it the customary thing that land is not a depreciable asset? You recover your investment from income after taxes rather than taxable income? As I say, I am confused here. I am not exactly clear in my own mind as to just what the issue is. I do think that you are implying that under the depreciable capital cost column it should include $100,000 for the land.

MR. BURN: I suppose, Mr. Perry, the usualness of the unusualness in which you view this would, to some extent, revert to the intent when you made the investment. That is, the owner of a manufacturing business, I think you could say that if he owns his manufacturing plant, the land on which it is situated is part of the perpetual inventory of his business, whether he remains located on that site or not. He probably at some time will acquire another piece of land in substitution for it, on which to erect another site. We, of course, are talking in terms of a straight investment. At the terminal life of that building, we would be confronted with a choice, and I suggest that the normal choice would be that the land would be sold off at that time, let somebody else develop it, in which case the proceeds from the sale would be taxable income in our hands.

The only alternative would be to enter into an arrangement of somebody putting another building on the site, in which case we would be limited to future depreciation on the value of the building, of course, even though the terms of the new lease would then include

the rental value of the land and the return would be exorbitant to our book cost and, similarly, our taxes would be much higher because there is no book cost on the land.

COMMISSIONER PERRY: Doesn't this mean that there is really an implied second recommendation here. That is, that you be allowed to amortize your land costs as well as your building costs?

MR. BURN: Not really, because we are obliged to amortize our land costs under our governing legislation.

COMMISIONER PERRY: I mean for tax purposes you have got to.

MR. BURN: We say that for tax purposes two sets of accounts should be parallel, which does not include the land.

COMMISSIONER PERRY: Your main proposals are largely a matter of the timing and this, incidentally, does not destroy the other case because you take up the $100,000, still have an excess of ---

MR. BURN: Mr. Coyne made the suggestion that we limit ourselves to the 85 per cent and that would pick up the land. We have picked up an example here where the land represents 20 per cent of the value. Whatever relation the land bears would depend upon the nature of the structure. I think 20, 25 per cent probably represents a reasonable value say of a downtown office building.

If you went into an industrial plant, if I may limitmyself to Toronto, I know it better, say in

Don Mills you would perhaps fall into the category of about 10 per cent. If you went into a well-situated service station in a metropolitan city, it may run as high as 50 or 60 per cent and the value of the structure is very little.

COMMISSIONER PERRY: Thank you very much.

THE CHAIRMAN: I am still puzzled, I am sorry. Bringing myself clearly to the lessor and your recommendation which is that there should be brought into income only the interest element of the rent, when the owner brings in that interest element and is taxed on it, he is not bringing capital cost allowance, I would not suppose, or perhaps what is intended is he brings in the gross and takes off from the gross capital cost allowance so as to bring it down to the net figure which is the interest element, because if he does not do that, I do not see the mechanics of achieving recapture depreciation upon the sale by the owner. How does one achieve that?

MR. BURN: I wonder if we could use the term that we would be the owner of the property, the occupant would not be the owner, of course and as part of our submission we have unreservedly stated if at any time there is a disposal of the assets at a price that is higher than in our books, we undoubtedly would be subject to taxation on that difference.

THE CHAIRMAN: I wonder how you work out the mechanics? You have brought into your income only the interest. There would have been no capital cost taken in your accounts?

MR. BURN: Yes.

THE CHAIRMAN: There would be?

MR. BURN: Yes. Now if I may go on, at the present time a quotation will be given on one of these leasebacks, an annual rental of eight thirty-two of the cost price and that will be a combined factor of six and a half per cent interest and capital recapture over the 25 years, if you amortize it.

THE CHAIRMAN: I have seen it quoted in that manner. I was just a little concerned about the tax accounting, taking your words literally that you perhaps bring in only the interest, but I think what I am asking is that your accounting would be in the form where you would actually bring in your tax accounting the total amount of rent received and you would take off from that the capital element of that rent which would be the equivalent of capital cost allowance?

MR. BURN: Yes.

THE CHAIRMAN: So if you sold, you would then achieve a recapture to that extent?

MR. BURN: Yes.

THE CHAIRMAN: That is how it works out mechanically?

MR. BURN: That is right.

MR. COYNE: Mr. Burn, turning, if we may to your request for mortgage reserves, in which you develop your recommendation at page 12 and following in your brief, perhaps as a first question on this point I am asking you what, in your view, is the justification for a special reserve being permitted against

mortgage losses at all?

In other words, why should there be any Section 85(g) as it now exists? Perhaps I can just add: there are general provisions inthe Act which permit traders and also lenders to set up reasonable reserves against losses, or doubtful debts. Why should mortgages be singled out or why should lenders, lending money on mortgages be singled out for this special treatment with respect to reserves?

MR. BURN: Well I think the justification for it is that on the basis of past experience of most of us, we only have one rather bitter experience in that regard, the loss has not been inthe nature of a short cycle, which is perhaps more customary with industrial or trade losses. When we have run into periods when the need for reserve has been apparent, it has been periods of long duration. While no company went by the boards during the last period by reason of it -- may I backtrack just a little? The period roughly extended from the early '30's, and most companies I suggest did not dispose of their real estate holdings until near the end of the War, so we are talking in terms of 13 to a 15-year cycle and that to absorb the inherent liability that had been built up over a period of perhaps 20 or 30 years, in one or two or three years income, is subjecting a company to a considerable strain and can go to the roots of not his financial stability, but could create a marked pattern in its earnings curve which I don't think is perhaps fundamental accounting, as those contingent liabilities had been created in many

years and I do not think it is possible to sit down at the end of a year and consider your mortgage portfolio and appraise it with the same exactness as, say, a man can do with his credits.

MR. COYNE: Well I wonder if I could just pick it up there for a moment. You make the point, you make this precise point in paragraph 2.13. That is, you say it is not possible to assess the qualities of the mortgage portfolio in the same way as one can with ordinary trade accounts. May I just question you on that and compare mortgages, not so much with ordinary trade accounts, if that is merchandising accounts receivable, but other types of loan accounts as, for example, the finance companies which may have a whole series of outstanding loans unsecured. They are entitled to establish a reserve under Section 11(1)(e), as I understand it, but they have to demonstrate what would be a reasonable amount to take as a reserve on the basis, I suppose, of the quality of their accounts.

Now why is it more difficulty to assess the quality of mortgages when, in contrast to unsecured loans where the only factor is the ability of the person at some future date to pay back the loan, in the case of mortgages you have a real security and that prime security for the payment back of the loan is not the rather fragile future of an individual, but the more permanent value of a piece of land?

MR. WELLS: I might suggest, Mr. Coyne, that in answer to your question, as I see it, is the experience in mortgage lending has suggested the need

for reserve. A mortgage investment is not a marketable investment; very often locked up for extended periods of time and the experience during the '30's did suggest that mortgage investment could be rather precarious and I believe that in order to encourage institutions and other investors to make mortgage loans available, this provision was made. Isn't that really the essence of it?

MR. BURN: Yes. I was going to suggest to Mr. Coyne an incident that occurred to me, when I speak of the different types of institutions. The first time I drove through Blind River, I noticed very luxurious trailers parked on the trailer camps and I said to my companion in the car, who happened to be the president of my company, those people are very silly spending $7,000 or $8,000 on trailers when they could go over and buy an N.H.A. home for $13,000.

I suggest both the owners of the trailers and the finance companies who might have liens against them were far happier in future years than the owners of the real estate or the mortgage companies who had liens against the houses.

MR. COYNE: I take it your point, and also Mr. Wells' remarks to mean that the distinct feature about mortgages is their long-term nature, and the fact that the funds are locked in. Does it suggest, perhaps, that nevertheless mortgages are often written for short, or relatively short terms?

MR.WELLS: You don't always get your money back at the end of the term. I think the fact that the

Government found it necessary or desirable to guarantee, virtually guarantee N.H.A. loans, for example, is very much to the point. They guaranteed these loans, or insured them to make a large volume of mortgage money available.

N.H.A. loans do not apply to old properties and very often it is necessary to enter into a conventional mortgage loan. I really believe that the provision is there to encourage institutions to make that type of loan.

MR. COYNE: And has it had that effect, in your judgment?

MR. WELLS: I think it has, yes. I think there would be less mortgage money available if that provision were not there.

MR. COYNE: May I suggest, in effect, that mortgage reserves are justified -- I am not speaking of the details of your recommendation except as generally, that there is an element of risk which can be catastrophic in certain circumstances, if those circumstances are developed? It may not be a fair question to put to you this morning, but it might be helpful to the Commission to know what the loss experience of trust companies, for example, has been in connection with their mortgage investments over, say, the last 15 years.

MR. WELLS: I would say that the mortgage experience over the past 10 to 15 years has been very good. We have had a very buoyant economy. I am sure that our own experience is fairly common to other

trust companies. We have had very few losses in mortgage loans but that does not mean that we won't have them before the mortgages mature.

Now in the '30's I think every institution suffered several losses on mortgage investments. We are very conscious of the fact that we may encounter losses before our mortgages are paid off. In fact, I think most institutions do provide reserve in excess of the cash allowed for income tax purposes.

MR. COYNE: That was the other question that I was going to raise possibly for your consideration, and that was as to what reserves against mortgage losses are in fact set up by trust companies in their own accounts?

MR. WELLS: Well I can only speak for our own company. We literally do not set up specific reserves for mortgage investments. We do set up inner reserves against all our investments and we have mortgage investments very much in mind.

MR. COYNE: Are those reserves contained in your public financial statement?

MR. WELLS: No, not ours.

COMMISSIONER GRANT: If I may add a word there, Mr. Coyne, I think that it is true that the Income Tax Department prior to the enactment of 85(g) did not permit a trust company to anticipate a bad debt in its mortgage accounts. They took the position that you had to incur the loss before you were allowed any write off.

B/RPS

I believe that is right, Mr. Burn.

MR. BURN: Yes, that is my understanding.

COMMISSIONER GRANT: Then that bears out what Mr. Wells has pointed out that the Section probably went in to give some encouragement to mortgage lending on the part of institutions such as trust companies.

MR. COYNE: In other words, Mr. Grant, you are saying, I take it, that prior to 1955 the National Revenue Department wouldn't grant a reserve, wouldn't allow that there was reasonable amounts that might be taken in reserve under 11(1)(e). Is this your experience?

MR. WELLS: I think that is so.

MR. ALLISON: Simply because it was so difficult to compute, actually.

COMMISSIONER GRANT: They insisted you take the actual loss before they allow you to write that off.

MR. COYNE: Do you think it would be helpful to the Commission if your members were able to submit to the Commission figures over a reasonable period of your loss experience?

MR. WELLS: I don't think it would be helpful to the Commission -- I don't think it would help our submission. I am morally certain that the losses haven't been very great in recent years but mortgage companies have engaged in this mortgage lending to a very great extent in recent years and it would only take a cold wind from the north to create conditions that might result in very considerable losses.

MR. COYNE: Of course your principal recommend-

ation in this regard is that three per cent reserve is inadequate and that you think it should be more proper at six per cent. I guess the obvious question . . .

MR. WELLS: Why should it be?

MR. COYNE: Why should it be six per cent? What finite basis are there for justifying a rate of six per cent? Is there a loss experience which could be related to six per cent?

MR. BURN: We quote in our brief in paragraph 2.15 the reported loss experience we had, admittedly during the most depressing years of 11.4 per cent.

MR. WELLS: I think it bears on your question, Mr. Coyne, that the real estate values in the last 10 or 15 years have increased out of all proportion to what they were before. Real estate values in that sense -- that of course is a measure of your risk in mortgage investment because they could come down very sharply, couldn't they?

MR. COYNE: I suppose they could. On this question of your survey, of the Dominion Mortgage Association survey where they show 11.4 per cent average loss over this period, I suppose it is true to say that this is rather an usual period in the sense that it almost exactly coincides with the great depression and with the second World War. Are there any surveys of a similar nature covering other periods? For example if you want to start in 1948 bringing it up to 1962, or even 1946 to 1962.

MR. BURN: The only figures that I would know, which I can't quote to you would be Central Mortgage

figures which would show the money in insurance funds.

Presumably that would be in relation to their total portfolio. Have any of you gentlemen seen these others? I could quote from memory, which isn't a dollar loss, but when Central Mortgage went rather extensively into the agency field, that is loaning direct, I think there was a foreclosure ratio of something about three and a half -- three per cent, I suspect, of the total number of units. What was the dollar value I couldn't tell you, but I know details are available.

MR. COYNE: But this Dominion Mortgage Association survey was simply a survey they made at that particular time? It is not something which they attempt to keep up to date or current?

MR. BURN: That is quite correct. I would suggest, not only suggest, I would think I would be prepared to admit that up until the period of perhaps two or three years ago - what is your experience there with this -- the loss would be so insignificant that it wouldn't be -- you could practically say it was zero, and perhaps the last two or three years there have been somewhat a smaller ratio, but in fact, many of these haven't been converted into dollars as yet simply because of the slow process of law. Excuse me, I am a lawyer also. By the time the foreclosure and the sales go through -- this has been the basis of our experience, and that real estate prices peaked out in the area we are concerned with around 1958 and there has been a somewhat greater incidence, although it is still quite small.

MR. COYNE: Notwithstanding is it fair to say that you don't attempt in your brief to justify the entries in the allowance, in the reserve as you recommend from three to six per cent -- you don't attempt to justify that in terms of any factual experience which could be identified as such?

MR. BURN: I don't think so.

MR. COYNE: In other words why six? For example, why not five, why not eight -- why do you recommend that it should be six per cent instead of three per cent? I put it to you there are no factual grounds of recent experience which were used to justify this recommendation?

MR. WELLS: I think that is right, Mr. Burn. We haven't any actual statistics to justify the rate of six per cent.

MR. BURN: That is right.

MR. WELLS: It is our judgment six per cent is better than three.

MR. COYNE: Wouldn't twelve per cent be even better?

MR. WELLS: That is right, it would probably be better but we probably would find it difficult to justify 12 per cent, but I think that observation I made before is still rather pertinent, as real estate values increase mortgage investments have tended to become more precarious. N.H.A. loans insured by credited Government are available to institutions and it seems only reasonable institutions in making conventional loans should have some protection against the contingencies

that might arise such as in the 1930's. I don't say we are preparing to suggest that the 1930's are likely to recur but there is an increasing reservation on the part of investors to make mortgage loans under present conditions having regard to the inflated values of real estate and so on. I think there is an increasing awareness of the possibilities of loss which we are seeking to reserve against.

MR. COYNE: Is it the opinion of your Association that an increase in the tax reserve of this nature would increase investment by trust companies in mortgage loans?

MR. WELLS: I would say almost certainly.

MR. COYNE: Well then, Mr. Burn, before leaving the subject of mortgage reserves and turning for a moment to your second point -- I am not sure in which order they appear, about the high rate of accumulation of reserves permitted in present legislation, I think you point out that although the maximum reserve allowed is three per cent it can only reasonably be accumulated at a rate of one-quarter of one per cent a year, so if their investment portfolio remains constant it would take twelve years to arrive at the three per cent maximum. Just to make sure that your thinking is clear on this, would it be fair to say that in your view if a reserve of three or six per cent or whatever it is is justified then apart from any immediate impact on a revenue there is no reason why a reserve should not be taken at once rather than gradually over a period of twelve or more years? I know that you recommend a

five-year period for bringing it up, but I think you couple with that a suggestion as far as any increases are concerned you should be entitled to take three per cent in a single year.

MR. BURN: Yes, let me say this: It is rather natural to say once a three per cent reserve was introduced you tend to think of that as their present normal line of resistance. I think it has been somewhat inconsistent and if the parties who had made the original proposal had envisaged, in fact, the rate of growth in portfolios as they have taken place since 2 this measure was introduced in 1955, if you have suggested that at the very least the accumulated growing percentage be applied to the portfolio as at that time -- in other words they didn't see any particular clouds on the horizon, but they were projecting themselves in the future and we haven't built up that reserve at the rate that we would like to feel is compatible.

MR. COYNE: Is there any relation between the risk of the loss and the age of the mortgage? In other words I put it to you in a brand new mortgage you have just entered into it might be hard to justify a reserve equal to three per cent of the total value whereas a mortgage that is 12 years old and has suffered the vicissitudes of circumstances in that period perhaps the larger reserve is warranted.

MR. BURN: I would tend to suggest somewhat the opposite. The worst position which I think a company could find themselves in would be to double its portfolio say in the year 1964 and then to run into a

minor recession in 1965 because the percentage of the loss, the percentage of the loss to the value of the house is, of course, in the order to two-thirds whereas under normal economic conditions the rate of repayment of the loan should keep abreast of the depreciation of the house.

MR. COYNE: Mr. Chairman, those are all the questions on that subject.

THE CHAIRMAN: Being an accountant, Mr. Burn, I am rather interested in whether or not this increase in the reserve is in relation to the best determination of income? I am afraid when these sort of proposals are made I am inclined to look at them as being of two purposes, the one purpose being to best measure the income, and that is an accounting matter, and the other one is to permit a concession for good national purposes as many, many industries have concessions because they are able to say they serve some good national purpose. Would your accountants be prepared to support this as the best measurement of income? You are not entitled to ask me that question either, Mr. Burn?

MR. BURN: Well, could I say that we have utilized to the full extent the allowance given under the Tax Act and further say we have done so and our balance sheets have so been certified by a good firm of accountants.

THE CHAIRMAN: That reserve has been deducted on your balance sheet and that is general, is it, with trust companies generally, they use these reserves as

deductions?

MR. BURN: I don't know of any company which is not doing so.

THE CHAIRMAN: Then the next question is would your accountants support an increase in reserve to six per cent as being a better measurement of income than three per cent? You see Mr. Wells said that six per cent was better than three. I was curious whether he thought that was a better measure of income or just that would be a better incentive to loan money on mortgages?

MR. WELLS: More adequate to the present needs.

MR. BURN: I think possibly if we convinced this Commission of the need for a six per cent reserve and Parliament was also convinced our accountants would be convinced.

THE CHAIRMAN: I hate to think you are right, but you might be.

COMMISSIONER GRANT: As I understand the arithmetic of these reserves it is going to be virtually impossible with a steadily increasing mortgage accounts to obtain the maximum reserve permitted in a 12-year period.

MR. BURN: Yes, Mr. Grant. It would have been an easy exercise, and I am sorry I haven't done it, but I would stress if I took our own experience and projected it out we might have flattened out somewhere in a 20-year period. Have any of you done that -- in between 20 or 25-year period?

COMMISSIONER GRANT: So that the actual reserve at the end of the 12-year period may very well be less than the three per cent, somewhere perhaps, between two and three per cent?

MR. BURN: Undoubtedly. That is if the present portfolio increases go on.

COMMISSIONER GRANT: So that the Association's submission would naturally follow that if the present method of computing that reserve is to be retained then it would be more realistic to increase the amount permitted, to set aside as a reserve some higher percentage point. This is the only tax free reserve that a trust company is permitted to set up apart from its reserve on real estate and its reserve on its moveables, is it not?

MR. BURN: That is correct, yes. On its real estate -- you mean capital cost allowance ?

COMMISSIONER GRANT: The trust company is limited to the amount of real estate which it may hold in its own name.

MR. BURN: Yes, just for the normal purpose of business.

COMMISSIONER GRANT: Well, is it your argument that this money that has to be put on mortgages represents a very large commitment to the public by way of borrowed money?

MR. BURN: Yes, I would think the constitutions of institutions vary depending upon the nature of the business they do, but for a company which is engaged in the deposit business in the order of 50 per cent represents

guaranteed funds. Is that the figure you would have given?

MR. NELSON: It would vary a great deal.

MR. BURN: It would vary from company to company. What most companies do, I suggest, is take a very large percentage of term money, almost all of their term money into mortgages, and by term money I mean money of say five years term, and a much less percentage of their ordinary demand deposits.

/RPS I have the Insurance Department statistics with me. I think this points up a fair average of companies actually engaged in taking deposits.

COMMISSIONER GRANT: A safeguard to the public is an element in your request for a higher reserve?

MR. BURN: That is correct, yes, and a secondary measure is it is the feeling of confidence which we hope it will warrant which might be affected by rather wide fluctuations in our industry.

THE CHAIRMAN: You could safeguard the public without any tax concessions?

MR. BURN: That is quite correct, you can. I don't know whether you are being absolutely fair to your shareholders if you do it by taking a reserve of that kind. Of course one way or the other, they are having to pay taxes on something which is not available to them.

COMMISSIONER BEAUVAIS: On page 15 you say that the average loss was 11.4 and, as you said, it includes the depression years of 1928 to 1933. Is it possible to guess what was the percentage loss from 1933 to 1963?

MR. BURN: I have not the figures available sir because, quite frankly, I didn't think of it but I interpreted that eleven point four figure in a different manner. I think if you are applying it to a cycle which is a matter of judgment, but I think yourcycle ends in 1948 and you might say it began in 1900 or 1915 but I think of it as a termination of a cycle rather than

the beginning of one and I suggest that the second cycle started in 1948 and I would hope that another one has terminated and that we are in a leveller plane of our economy and we would tend to, I think statistically and I am looking at my confreres here....

MR. SMITH: I don't know that I can speak from an economy point of view and can think in cycles, but it seems to me that the historical period pre-War to 1946 is obviously abnormal for the reasons that were brought out. By the same token, I would be inclined to think that the post-War period, up to 1956 as being abnormal and perhaps a normal period, whatever this means, but normal in the economic sense, competition, and so on, is what we have experienced since. I doubt that you can get any particular period which cannot be debated as being available in history, in a period which is available, in statistical history, which cannot be debated as having some abnormality in it except the very recent one which is what the experience now is, what I think this Association is becoming apprehensive about, this new sort of environment that we are in that promises, presumably, to be normal.

COMMISSIONER BEAUVAIS: You see I was mentioning that because eleven per cent seems very very low. I remember in the depression years it was far more than that. It might be 30 or 35 per cent. I was trying to find out whether it was more than 30 per cent after the depression, from 1933, 1934 to date as a guess, not a specific thing.

MR. BURN: Well I would think sir that you can

say on the basis of what we said -- the loss experience has been so low that if you -- I don't know whether my arithmetic is correct here, but you can practically average out your eleven point four with zero to bring it up to date and then, of course, there is quite a difference in the amount in mortgages in recent years -- it is far greater than it was in the base period and if I may comment on one of your remarks, I would suggest that at some point the loss ratio would have appeared to have been greater than 11.4 per cent but by force of circumstances many of the companies could not dispose of their real estate, would like to hold on to it and they found it did work out to their advantage and cut their losses.

COMMISSIONER BEAUVAIS: Another point: when you suffer a loss, do you charge that against the reserve or against the income, earnings?

MR. BURN: I have had a difference of opinion expressed by accountants on that point. Our anticipated procedure, I might say because our loss experience for this year will be the first, is to charge it against reserves.

COMMISSIONER BEAUVAIS: Thank you.

COMMISSIONER WALLS: Would there be any variance in the type and size of mortgages that you handled in that period, 1929 to 1948, as compared to what you are handling today?

MR. WELLS: I can answer that, I think. I would say that the mortgages today are very much larger than they were in the '30's.

MR. NELSON: The percentage is higher is it not?

MR. WELLS: The percentage is somewhat higher. I think we used to be restricted to 60 per cent, now we are allowed 66-2/3. I think you can put this in its right context if you think of these reserves as an insurance against contingencies that might arise. You take insurance, you do not hope for a loss but the need for insurance is, nevertheless, apparent and I don't think we have to rely on a loss experience in recent years to justify our suggestion.

COMMISSIONER WALLS: I was rather looking for a cause for the statistics that you showed ~~covered~~ covering the years up to 1948. Is it not a fact that the trust companies are much heavier in large industrial mortgages today than they were during that period?

MR. WELLS: I would say yes, very much more so.

MR. BURN: Mr. Chairman, Mr. Smith has brought to my attention a more specific answer to a question put by Mr. Coyne and if you would like it in the record, in our submission, the Trust Companies Association's submission to the Royal Commission on Banking, we showed that at the end of 1960, 37.1 per cent of the company's owned asset in its guaranteed funds were in mortgages. That was on an industry basis.

COMMISSIONER PERRY: I just have a very minor question on paragraph 2.11 and that is as to whether all the information there refers to your mortgages excluding N.H.A. mortgages because on page 13 there is

a reference made to a figure of .81 of the total mortgages invested. Am I to read that as meaning total excluding N.H.A.?

MR. BURN: That is correct, yes.

THE CHAIRMAN: I think we will break right now. We will stand over for 10 minutes.

---A SHORT RECESS.

---FOLLOWING THE SHORT RECESS:

THE CHAIRMAN: All right Mr. Coyne, we will commence.

MR. COYNE: Thank you Mr. Chairman. This now brings us, Mr. Wells and Mr. Burn, to the section of your brief which makes recommendations with respect to estate taxes and in introducing this subject, commencing at page 17, you refer to the three main objectives in the imposition of death duties and then proceed with really an historical sketch of the development of death duties as a source of revenue.

You point out that although in the provinces when they were first introduced, they were a significant source of revenue, today this significance appears to have declined and that in the Federal field, in your judgment, they are not a significant source of revenue. For example, in paragraph 3.13 on page 21 you say:

"But with occasional exceptions, the
"relative importance of the revenues from
"these channels has declined since their

"inception. Thus, while succession duties "may have been introduced for revenue purposes, "this objective appears now to be a minor "one."

And again over the page, in paragraph 3.19:

"If, as we have suggested, the revenue "objective in estate taxation - particularly "at the Federal level - is of secondary "importance, and if further the final "accounting objective can be carried out "independently of the taxation aspect, it "seems clear that the design and structure "of the tax must have been dictated by this "social objective."

I would like to start out by asking you general questions along these lines. If it is a fact that death taxes historically to date have not been a significant source of revenue to Governments, is there any reason why they should not be? In other words, what do you have to say about the levels of rates? I am instructed that really in various representations the Commission has received to date, in connection with estate taxes, and they have been quite voluminous particularly with regard to exemptions, really nobody has made any complaints about the rates of estate taxes. Is there any reason why those rates should not be changed and, for example, is there any reason why if revenues were necessary that, for example, the rates might not be doubled in order to provide significant revenues from those types of taxes?

MR. BURN: Perhaps we are not specifically speaking in terms of doubling. May I suggest that even in terms of doubling we would be taking of three per cent, three and a half per cent on Federal levels but if Imay refer you to paragraph 3.33:

> "To embark on this course would be
> "to adopt a different social objective than the
> "present one, and objective aimed at
> "confiscating wealth rather than limiting
> "its accumulation, as we understand the
> "objective now to be. Such an objective
> "would belong within a different political
> "philosophy than the one which the
> "majority of Canadians now embrace."

Now of course, if there is any merit in what we have said in our brief concerning the imposition of hardships on widows and dependent children, it becomes doubly significant if you speak in terms of doubling rates of taxation.

MR. COYNE: Well perhaps we will get into the question of the exemptions and hardships a little later, but of course, I think you might agree, the question of hardship is a function of both rates and exemption, and I am speaking at the moment merely of rates. I appreciate your point in paragraph 3.33 and where you talk about confiscation and you think this would be a different social philosophy, I took what you were thinking of in that paragraph to be, for example, if the rate was one hundred per cent above basic exemption, in point of fact, as your tabulation opposite page 24 indicates, at

the present time the average tax burden on taxable estates under the Federal Estate Tax Act is 15.9 per cent and you point out that the effective rates start at 3.3 per cent for the smallest taxable estate and rise to 36 per cent for the largest estates.

Now do you have any comments to make in connection with that particular level of rates? Are they inviolable?? Would any increase above the present rates constitute this confiscatory objection you refer to in paragraph 3.33?

MR. BURN: I would think, using it in its broadest term, it would be -- in the lower portion of the section we deal with the question of the disposal of private companies, and we point out that there are certain defensive measures being taken by people on the basis of our experience who are the owners of private companies and who have a strong motivation to retain; any suggestion as to increasing rates would make that objective that much more difficult, or in many cases perhaps impossible.

While it is true there would be a residue left in the hands of his family, in terms of thinking, he might -- his family might think of it in terms of confiscation if they had to dispose of the family company, by reason of the impact of taxation.

MR. SMITH: Perhaps we have another general point here I would like to comment on. We refer in the text, I haven't been able to spot the paragraph, to what might be described as the typical composition of the smaller estates in which you would find perhaps ---

MR. COYNE: Paragraph 3.30 on page 26.

MR. SMITH: Yes, it is those thoughts that I simply wanted to bring to your attention, that three per cent of the six per cent tax burden is not a particularly impressive figure, perhaps, but just a look at the actual dollar amount, an amount of let us say $9,600 on an estate of $110,000 could be the basis of substantial tax liability, if the composition of the estate were such that the liquid segment of it was a smaller part of it, as would probably be typical in estate sizes of this range.

MR. COYNE: Of course, that tax burden would be modified, if your recommendations with regard to exemptions were accepted, and isn't it in the sphere of exemptions that one can seek to alleviate these conditions of hardship, rather than rates?

MR. SMITH: Yes. I thought your question was what do we think of the level of rates? I was just trying to suggest a simple percentage statistic could be misleading without bearing in mind what makes up an estate. It may be more burdensome than six per cent looks like. That is really all I am saying.

MR. COYNE: It depends on the circumstances of each individual estate?

MR. SMITH: Yes.

MR. COYNE: Without labouring the point, is it fair to say that you really make no recommendation as to rates at all? That is, you are not saying that the rates are, at the present time too high or too low?

MR. BURN: That is right. We have made no

recommendation. We did not tackle rate structure. I think, speaking extemporaneously, there would be a feeling that the upper limits in this and in other forms of taxation, when they reach the levels which they are, might tend to have some secondary effects which inhibit -- I am seeking the word -- adventure or inhibit enterprise but we have not made any recommendations with regard to that.

MR. COYNE: Incidentally, just one question on this tabulation opposite page 24 where you demonstrate the tax burdens, the existing tax burdens at various levels.

RPS

I take it there we are dealing only with the burden of the Federal estate tax?

MR. BURN: That is right.

MR. COYNE: If one were to want to know the tax burden of death tax as a whole you would have to take into account Quebec and Ontario, and I suppose now British Columbia succession duties as well.

MR. BURN: Bring back in appropriate allowance under the Federal Act for the exemption of this tax.

MR. SMITH: It wouldn't be added on after. There would be a credit.

MR. COYNE: These figures in the table are after credits for Ontario and Quebec succession duties as I read it.

MR. SMITH: No.

MR. BURN: No. The reason for the relatively low upper percentage where you would suspect a figure in the order of 52 or 53 per cent is everything over a million has to be added.

MR. WELLS: Is it right, Mr. Burn, these figures represent substantially succession duty burden in Canada having regard to the Provincial allowance?

MR. SMITH: I think the key word is taxes assessed which would imply as opposed to being collected by the Federal Government -- would apply that the credit has not been deducted as it were in these figures. These were reported in the national revenue statistical book.

MR. COYNE: Is it fair to say that taking your tables and the estates of any size then within that

seventy-two and seventy-four coming to one-forty. It doesn't reconcile with the eighty-five at all.

COMMISSIONER WALLS: That is right.

COMMISSIONER GRANT: Are we not confusing the issue. We are adding all succession duties for the Provinces of Ontario and Quebec. We are not concerned here with the take in the Provinces of Ontario and Quebec. We are only concerned with the take of the Estate Tax Act less what it has to rebate to the Provinces of Ontario and Quebec.

THE CHAIRMAN: Perhaps we should leave it to the witnesses. I am not getting it myself.

MR. BURN: My understanding is substantially the same as Mr. Smith's. We had the same question arise at our committee level and we answered it to our own satisfaction then. I just quickly tried to find out the comparative figure. I am quoting from the Bulletin on Canadian Taxation published by the Tax Foundation in July, 1962 when they show Federal revenue at 71.6 million on succession duties. During the same period the Provincial revenue in Ontario and Quebec were in the neighbourhood of $51,000,000. As we had prepared our work the relation between the $85,000,000 figure and the $82,000,000 figure was something of a coincidence. Isn't that correct?

MR. SMITH: That is correct.

MR. BURN: We satisfied ourselves this was an aggregate assessment and that could be somewhat borne out, sir, when you refer to this 36.3 percentage and we are dealing with a very small group but that would

seem to bear the relationship where the effective rate of tax on $950,000 is $309,000 which is, I presume, 33 per cent and increases to a maximum of 54 per cent under the Act, so that that 33 per cent would seem to be a fair range in estates over $1,000,000 for the aggregate assesment under the Federal Act.

MR. COYNE: I suppose the answer to the confusion, Mr. Chairman, and I don't know whether it is helpful is to point out this is purely a sample. Of these 3,400 estates with aggregate tax value of $520,000,000, the tax would be assessed in the Federal Tax Act at $83,000,000, but if, in fact, the total collected by all jurisdictions is $140,000,000 they were collected far more than 3,400. We are dealing only with a sample to illustrate the burden of the rates rather than the volume of collections.

THE CHAIRMAN: I can appreciate that, Mr. Coyne. You started off in your examination by talking about quantum of tax collected by the Federal Government. I really don't know what this is.

MR. COYNE: Perhaps the witness could answer this. It is pretty close to being....

MR. SMITH: It was $83,000,000.

MR. COYNE: It was $83,000,000 for no reason other than coincidence.

MR. ALLISON: If we look at appendix B, table A, we may have the answer in that.

MR. COYNE: That is at the back of the brief.

MR. ALLISON: That is right. They show in 1962 Federal tax collected $97,000,000 based on estate

and succession duties collected including amounts subsequently paid to renting provinces. Below that it shows the amounts that went out to each of the renting provinces with Quebec and Ontario assessing their own which does not represent all payments there.

MR. COYNE: So in the 1962 column if you take $87,000,000. . .

2 MR. ALLISON: Plus $24,000,000 and $40,000,000.

MR. COYNE: Plus $24,000,000 and $40,000,000 for Quebec and Ontario which is $64,000,000 it would give you a total of . . .

MR. ALLISON: Estate taxes.

MR. COYNE: Total succession duty and estate taxes . . .

MR. ALLISON: Collected at all kinds and at all levels.

MR. COYNE: I get $151,000,000 as being a total for all of Canada. Thank you very much indeed.

When then, going on I think we are leading into your recommendations concering exemptions. Before getting into your specific recommendations you stress what you regard as having been the social objective of this tax. For example on page 22, paragraph 3.18 you say:

> "The underlying philosophy would appear
> "to be that unrestrained accumulation leads
> "to a concentration of wealth in the hands
> "of a few and this is undesirable from the
> "standpoint of equality of opportunity."

In other words in your view that has been the

philosophy, underlying philosophy of the tax. Would you care to express any view as to whether this is a desirable social objection to continue to pursue in Canada today?

MR. BURN: I think you might obtain as many diverse opinions on that subject as there are executive officers of trust companies, sir. Mr. Wells, I think the Association's position -- maybe I should let you express it is that we have accepted the situation as it stands today. Would you care to elaborate on that?

MR. WELLS: Well, I don't think I can elaborate very much. I think you put your finger on it when you say we have accepted this philosophy. I suppose that one can argue that an accumulation of wealth is what makes our economy possible and anything that interferes with that accumulation of wealth does inhibit the growth of the economy. Having said that I think we would also have to accept the fact that this has become part of our whole political philosophy, not only in this country but in other countries, and I don't think it would occur to the trust companies to suggest that it shouldn't be.

MR. COYNE: I suppose if you didn't, in fact, accept this social objective you would have recommended that the tax be abolished?

MR. WELLS: That is right.

MR. COYNE: So that your position is that you accept this philosophy, I think is the way in which you put it?

MR. WELLS: That is right.

MR. COYNE: However you do point out in the

following page, 23, in paragraph 3.21 that accepting this social philosophy there are, nonetheless, two important constraints upon the pursuit of this objective and one is, in your opinion that any attempt to define levels of wealth for taxation purposes should recognize the increasing affluent nature of our society and secondly the imposition of estate taxes should not involve hardship on dependents. I take it that you mean here pursuit of these social objectives has to be modified?

MR. WELLS: That is right.

MR. COYNE: In order to take into account these two other factors. This, of course, leads into the discussions of exemptions and your recommendation of changes in this respect. I am leading up to this sort of question which I would like to put to you: do you recommend variable exemptions for a widow -- for the estate of a decedent, leaving a surviving widow on the grounds of alleviating hardship? This is one of the two constraints that you feel should be proper?

MR. BURN: That is one of the grounds. That is -- we point out that it is directly related to the standards which the marriage enjoys before the death of the husband. I think the second ground I mentioned in our brief -- it also recognizes the widow's contribution to the acquisition of the estate.

MR. COYNE: Taking up your hardship point you are suggesting hardship is a subjective rather than objective matter. Let me put this example to you: a widow having a million-dollar estate can't, I suggest, by any accepted standard of hardship, be said to be

suffering hardship under the structure or rights and exemptions which we have today.

MR. WELLS: It would be a hardship if that widow had been enjoying, I suppose, the fruits of a very much larger estate to have to adjust her standard of living to live on $100,000. I would say it would be a hardship!

MR. COYNE: It would be a hardship to her, Mr. Wells, but I am not suggesting she would ever have to adjust her standard from $1,000,000 to $100,000. She would have what was left from the $1,000,000 under the existing exemptions. It may be a hardship to her if not a hardship by any accepted standards that the Tax Authority can take into consideration.

MR. BURN: You are placing, perhaps, a weak argument in our hands. Somewhere in our brief we say a $1,000,000 estate is not typical. I would affirm a suggestion which was made, that we have made that perhaps hardship is, perhaps, subjective. That is what goes to the widow and children, and I suggest it could be measured in decline of standard of living. It is a real hardship in my opinion and in the opinion of this Association if through half of the formative years the children who have been by reason of the qualities of their father have been used to accepting certain things in life - a measure of reduction is in my opinion, I am sorry, in our opinion a measure of hardship.

MR. COYNE: Hardship to them.

MR. BURN: Yes.

MR. COYNE: In the sense that it represents

some diminution of the fruits they were enjoying before. Picking up your point about typical, your concern that the million-dollar estate is not typical -- is not because there are so few of them. Let me put this proposition to you: that the very numerous small estates are not typical in terms of the social objective which the tax is aiming to pursue because if the basis of estate tax is that all estates should be allowed to be tax-free, that is not typical of what the Act is trying to accomplish at all.

Now is it not the larger estates that are indeed typical from the point of view of the necessary objective of the legislation?

MR. BURN: Well, let us say the working of this social objective is quite evident in the large estate.

PS

In that sense I don't know whether "typical" is the word you would use, the target is well-defined. In our submission, when we are talking of typical estates, we have in mind the elimination of the upper levels and lower levels and, presumably where your maximum number comes in the range of, in the order of $150 to $300 thousand dollars which I think is classified by the example. It really goes below that, certainly from $100 to $300 thousand dollars would represent the vast numerical majority, if you eliminate both upper and lower ends.

MR. COYNE: Then Mr. Burn might this not be the proposition, that if those are typical estates, for which some relief should be granted in the alleviation of hardship, shouldn't the relief be limited to that type of level rather than have the relief extend to the largest estates, in which event I suggest to you that your recommendation, if it were accepted, would far from just alleviating hardship, would put a constraint upon the social objective, would really destroy the social objective.

If there is a million-dollar estate, and there is $500,000 exemption, what has happened to the social objective that the Act is trying to pursue?

MR. BURN: These figures were included in our brief because they merely became a matter of conjecture, but there is a second line of taxation on that residual estate with no surviving spouse so the exemption would be removed on the second taxation.

MR. COYNE: Your point is that the objective

is really pursued in two stages?

MR. BURN: That is correct.

MR. COYNE: Through the first estate, in the hands of the widow, and then the ultimate beneficiary?

MR. BURN: Yes.

MR. COYNE: Then I would like to refer you to page 26, paragraph 3.30. You refer in this paragraph, and in the immediately succeeding paragraphs, to the fact that family circumstances vary greatly and, therefore, presumably the hardship which the death imposed will vary, the degree of hardship will vary accordingly and you say in regard to greater needs:

> "We do not feel that considerations
> "such as these are given adequate weight
> "in the design of the present structure of
> "exemptions."

Now I suggest, if I may, or I infer that in your view your recommendation would go further to make these -- would give greater weight to these considerations than does the present structure, and I put this example to you and perhaps you might comment on it: Perhaps it is an extreme example, and you can criticize it if you wish but take this example of the million-dollar estate, in the first case if the man leaves a widow aged 65 with grown-up children, the estate would have an exemption of $500,000. If the mother is already dead and she leaves three orphan children under the age of 15, which I would suggest to you is circumstances where the overall family needs are much greater than where there is an elderly widow, the exemption could only be $175,000

Now under the present structure of exemption, the situation is just reversed. In the case of an elderly widow there would be an exemption of $60,000. In the case of the orphan infant children, there would be an exemption of $85,000. In relation to the weight that should be given to these family factors, could you comment on that?

MR. BURN: Perhaps your example is sound in the ages you have selected, but I do not necessarily accept your proposition that the family needs are much greater in one case than the other because we primarily had in mind the family needs of the children until the time that they are self-sufficient; they had been educated.

Where you have a widow surviving, you have the unknown quantity of her needs for the duration of her lifetime. One is measurable in terms of years, the other is not.

MR. COYNE: In other words, I take your point to be that the infant children, they should be protected until they have reached their maturity and are on their own. Whereas, the widow may have to be protected for a longer period through her remaining lifetime?

MR. BURN: I might say that you have to take some arbitrary date. The reason that we, in our submission, selected the age 25 was that under normal extended higher education, that seemed to be about the time when a child finishes normal higher second education.

MR. COYNE: I was going to ask you the question about why you picked age 25 in the variable exemptions that

you are suggesting for children. I suppose it is quite true that nowadays if children are going in for professional training, and that sort of thing, they may well be still completing their education up to the age of 25, but are there not a great many cases where that is not so?

Would it be logical, do you think, to take those circumstances into effect in the sense of making additional exemption beyond, say, the age of 21 conditional upon the child in fact being in a condition of support, or of further education?

MR. BURN: Well that would be equitable. May I suggest the point is minor. 25 wasn't the extreme age limit. We thought in terms of professional courses of seven or eight years above the normal four-year course in university. Whilst it is possible to do that under the Income Tax Act, there is a continuing source of revenue and a continuing factual situation. In the case of estates you cannot, when a child is 15, honestly project what that child's needs are going to be. You have to take some arbitrary standard. I would suggest that if the father dies when the child is five, who is to say that child will be going to school when he is eighteen, or when he is twenty-eight?

MR. COYNE: I am not sure that I have made my point. As I understand your suggestion, it is that the basic child exemption should be $25,000 for any child that is under the age of 15?

MR. BURN: Yes.

MR. COYNE: And then taking the ages of the

surviving children, they would be diminishing by $1,000 for each year of age to age 25, at which time it would be $15,000, and I am just suggesting that there would be an awful lot of children between the ages of 21 and 25 for whom it would be very difficult to justify any special exemption from estate duties, particuarly at present-day starting salaries for young people, as I understand them.

MR. BURN: Having a child of 21 and still going to school and no starting salary -- however, I think your point is well taken, that if the child were over 21, you would look at the actual factual situation which then obtains, which might lead to some administrative difficulties. Some children have been known to leave school at 19 and go back at 22.

On your other point, I think percentage-wise we perhaps couldnnot justify -- those statistics are available, something like 20 per cent of children enter high school and go on to university. I think the social objective would be pursued if, rather than deprive any of that 20 per cent from the chance of a higher education, you should lean in the other direction.

MR. COYNE: In any event, if a modification of that kind were appended to the view you have in mind, it would not destroy the principle that you are aiming to implement here?

MR. BURN: No.

MR. COYNE: Just turning for a moment to the question of the variable exemption, and I suggest to you that the most significant feature of it is the fact that

it could make such a spread in the exemption, relating your suggestion of a variable to widow's exemption, to your recommendations in respect to quick succession, which you deal with in paragraph 3.50 and following:

"We are primarily concerned with "instances of quick succession where the "degree of relationship between the ultimate "beneficiaries and the deceased was very "close."

The case of the death of a father followed shortly after by the mother, leaving a family of young children:

"In this case the impact of succession "duties would be very heavy if the father "had left his estate outright to his wife."

Now although I can see that that can be true under the rules today, is it necessarily true under the proposals which you are making? I put this to you, again taking this million-dollar estate, if I may, if there is a surviving widow, the estate has a $500,000 exemption, according to your proposal?

MR. BURN: Yes.

MR. COYNE: And then let us say that it is an elderly widow with three grown up children. Then if she dies within the first year, the whole of that property that she received from her husband, with the benefit of the $500,000, would pass free of estate tax to the ultimate beneficiaries? Is that correct?

MR. BURN: That is correct. That is, the $500,000 which she received as a marital exemption would

be brought into her estate. It was not taxable in the first estate so the $500,000 which would fall into quick succession, would be exempt.

I think you also appreciate that we could not come into this room with the assumption all our proposals would be accepted carte blanche and so we had to point out what we thought were perhaps parallel weaknesses and presumably there could be some integration of the measures. If one were accepted, I would presume, under such circumstances, that there might be very well an exemption under the quick succession provisions in relation to property which had been acquired within the five-year period under the marital exemption. Would that be consistent with your understanding, Ken?

MR.COYNE: I think I understand your point. You say that the impact of duties would be very heavy if the father had left his estate outright to his wife. As I understand it there would be numerous incentives for leaving property outright to his wife up to the value of the exemption because in that way, in the example I pose, there would be an exemption of $500,000, whereas, if he left a life interest to his widow that was worth $100,000, that would give to his children only an exemption of $100,000?

MR. BURN: Yes. Of course our submission is related to practical circumstances when we say the duties would be heavy.

MR. COYNE: Would it be fair to say that your recommendations, as to quick succession, might have to be concerned with the structure of exemptions which

were to be built into the Act?

MR. BURN: That is right. If our first recommendation would be taken, it might very well be the modification in our second.

MR. COYNE: What you have in mind, in connection with quick succession, is to alleviate hardship rather than provide any possible advantages in the event of quick succession?

MR. BURN: That is right, to alleviate hardship, that is the most outstanding case, but I think perhaps it is also pointed out that this question of social objective has been basically met.

MR. COYNE: You would agree the two questions would have to be considered in relation to one another?

MR. BURN: Yes.

MR. COYNE: Mr.Chairman, I was now going to pass on to -- turning away from this question of exemption -- to some of the other recommendations in the brief. Would any members of the Committee have any questions?

THE CHAIRMAN: With regard to succession duties?

MR. COYNE: Yes.

THE CHAIRMAN: You are staying with the same subject?

MR. COYNE: Yes, still staying with death taxes.

THE CHAIRMAN: I think you had better continue on death taxes, because I think it is a little hard perhaps for us to sort out our questions between exemption rates and different matters. I have one question

which certainly bears on the two.

MR. COYNE: I will just proceed on through this section. Turning then, Mr. Burn, to your next recommendation following those exemptions we have been speaking about, and that has to do with the imposition of tax on pension and other periodic payments, and I take it that your recommendation is that the annuity should be given its actuarial value at the time of death, and the rate of tax, and the amount of tax struck but that it should only be charged, the amount of that tax should only be charged against the annuitant over the effective life of the annuity?

MR. BURN: That is right.

MR. COYNE: So that, for example, if the tax on the commuted value was computed to be $10,000, and the life of the annuity was 10 years, she would pay $1,000 a year?

MR. BURN: I think in all fairness you would have to relate, or apply another factor. Let us make an example possibly simple, but not necessarily accurate: if the commuted value, if she were receiving, say, if the aggregate of her payments received over expectancy were 20 per cent more than the commuted value, then the tax instalments also should be 20 per cent more. If there is an annuity of $1,000 a year -- let us say an annuity of $1,200 a year, and the commuted value is $10,000, in other words over the ten-year period, the widow has actually received $12,000. Whereas, she was being taxed on $10,000 because the payment of taxes is deferred and I would think that whatever tax was attributable should be increased by 20 per cent.

PS

MR. COYNE: Is that not the substance of your recommendation here?

MR. BURN: That would be equitable.

MR. COYNE: So that in striking a rate of tax and the amount of tax to be paid you would bring into the value of the estate not the commuted value but the total anticipated payment you would receive for the actuarial life of the annuity?

MR. BURN: No. I didn't explain myself properly. Let us say that there is a tax of 40 per cent on the commuted value, that we assess it the same as we do now then the rate of taxes on the payment should be 40 per cent so that the actual amount of taxes paid over a period of 10 years would be more or less within the present value of the tax.

MR. ALLISON: To put it another way, Mr. Coyne, supposing the commuted value is $100,000 in the estate and it could be established arithmetically that the estate tax applicable to that particular commuted value is $10,000 this means the effective rate is 10 per cent. What our suggestion is a deduction at source for the life of the annuity whether a shorter period of a longer period, morality rate of 10 per cent on the exact life expectancy but the exact amount of tax would be shorter, less, longer, more.

MR. COYNE: This is the way I understood it and in particular that if the payment extended beyond the actuarial life of the annuity the annuity would continue.

MR. ALLISON: Having already been taken at

source.

MR. COYNE: So that you have received a greater value of the asset than was anticipated when the rate was struck.

MR. ALLISON: When the rate was struck.

MR. COYNE: Would such a plan of this nature in your recommendation be at the option of the annuitant? Should the annuitant have an election?

MR. BURN: I would think probably because of the rather peculiar provisions in the present Act sometimes the executor is liable to pay taxes and sometimes the annuitant is liable -- I think it should be optional, possibly in the discretion of the testator although I can see some problems there, not so much from the taxation viewpoint as perhaps from the estate planning viewpoint. In other words it is conceivable that a testator might say I have bought an annuity of $100 a month for my mother but I want her to receive that free of deductions whereas in the case which we have elaborated more particularly in our brief where this pension might represent quite a considerable portion of the estate and excess liquid assets or go further in the estate duty. The election would allow us either way.

MR. COYNE: There is no reason or principle why some type of election should not be available.

MR. BURN: No.

MR. COYNE: As between the two methods of paying the tax.

MR. BURN: Yes.

MR. COYNE: In your judgment. One other small point on this: what happens, you speak of the way a pension is based on life or until marriage or for a fixed term in excess of five years. How do you go about valuing an annuity which is liable to terminate upon an event such as remarriage?

THE CHAIRMAN: I didn't hear your question.

MR. COYNE: How does one value for tax purposes an annuity which is liable to be terminated inthe event or remarriage of the annuitant?

MR. BURN: The present policy of the Department is to assume the continuing constancy of all widows and give you no benefit.

MR. COYNE: No, benefit of the remarriage factor at all. You are not suggesting any change in that, are you?

MR. BURN: No, because if the tax were only deducted during the period of the annuity well it would affect your aggregate value on your basic rate, perhaps if some short provision were left in as presently under the Act it creates tremendous administrative difficulties if you have to examine each one.

MR. COYNE: Well, I think that we have dealt with your recommendation in connection with quick successions which follows on in the brief after the subject matter we have been speaking of. I think they are perfectly clear. You then go on to summarize your recommendations having to do with these features of what are referred to as revenue implications on page 37, and following you make an analysis of what you think

would be the effect in terms of revenues of these and of subsequent recommendations which you also make whereby the Federal Government vacates this field altogether and you come up at the top of page 39 with an estimate that if all your recommendations were accepted the total revenues to all jurisdictions would be $61,000,000 which is something less than half -- without trying to pinpoint exactly what the total revenues are -- which is something less than half of the total revenues now derived from these sources by the Federal and Provincial Governments. Without trying to be facetious let me put this to you: do you think that all the machinery and apparatus which is necessary to collect these death taxes from all the estates in this country is really worthwhile for just $61,000,000 spread across 10 provinces?

In legal terms, Mr. Burn, are we not getting down to a sphere of reference, sometimes described, incorrectly as de minimis?

MR. BURN: In all seriousness I would like to underline the $61,000,000 is a minimum point. There are certain factors which we just can't calculate one of which we have mentioned. We have applied the exemptions to all estates -- we know that is not the case. A second factor we haven't taken into account is at the present time this marital exemption does apply to some estates in the Province of Quebec. In our example we have re-applied it again to these estates. A third factor which we can't calculate is the resulting revenue from the large estate being freed in the survivors hands both in terms of day-to-day economy and ultimate

taxation. Insofar as this specific question is concerned I can't honestly say that the administrative aspect as between $121,000,000 and $60,000,000 would rule out the recommendation.

MR. COYNE: I suppose also, of course, this part of the administration problems would be reduced, adminstration costs would be reduced if your proposals would be accepted because you are cutting out taxation in more than half the estates now taxed, as I understand it.

MR. BURN: Yes.

MR. COYNE: Now, the next recommendation that you deal with in your brief has to do really with the introduction of some form of uniformity into the legislation, and indeed the vacation by the Federal Government from the field of death tax except as a collection agency. This is in essence what you are suggesting here?

MR. BURN: Yes.

MR. COYNE: Without going into any political factors which might or might not affect this type of arrangement I would like to ask you one or two questions about the method you propose to accomplish this. You deal with the proposed form of taxing statute starting on page 40 at paragraph 3.66. You say:

"We recommend that there be one
"uniform Act administered at the Federal
"level. The revenue derived from the Act
"would be collected by the Federal Government
"as agent for the Provincial Government.
"Rather than a tax rental agreement this would

"be in effect an absolute vacating by the "Federal Government from this form of "taxation within Canada. In turn the "provinces would be required to suspend "their taxing statutes in favour of a "single federally-administered tax."

At that stage, I take it that your recommendation is that there be a Federal Statute imposing these taxes, but the taxes when collected would be turned over in appropriate amounts to the various provinces?

MR. BURN: Yes.

MR. COYNE: You go on "An alternative, "although much more cumbersome would be "to have a uniform Act enacted by all "provinces and administered by the Federal "Government as their agent".

I just put it to you that if this general proposition were acceptable to the various authorities that for constitutional reasons it might more likely be the second procedure which would be followed. You think that this method of accomplishing it would be much more cumbersome. If each of the provinces enacted a uniform Act why would this be more cumbersome than having a single Federal Act?

MR. BURN: To take a rather simple example, let us say in the first year of the enactment difficulties were found, obviously the process of amendment to go back to the ten provinces is more cumbersome than amending a single Federal Act.

MR. COYNE: It is trouble for the legislators.

Am I right in thinking it is very much the present system as regards to personal income tax?

MR. BURN: That is right.

MR. COYNE: In nine of the ten provinces.

MR. BURNS: Perhaps the cumbersome -- of course there would be other points, there would have to be prior work that would have to be done, but, however, I agree that constitutionally the second method seems to be better.

MR. COYNE: In any event if one route was followed rather than the other it wouldn't affect your thinking as to the desirability of the proposed recommendation? It isn't that cumbersome as to throw them out altogether?

MR. BURN: If we were only governed by administrative procedure and had no other considerations undoubtedly one Federal Act would be the answer. I think that it patent. We do have to take some recognition of what we think are very important.

MR. COYNE: Let me ask you this: assuming all the provinces wouldn't agree to a scheme of this kind would it in your view be worthwhile to introduce a partial system for the agreeing provinces, and, for example, as today in the personal income tax by the Federal Government in nine provinces and corporation income tax in eight?

MR. BURN: I think my answer has to be tempered somewhat by the extent of dissent. I think there would be -- I think it would merit in numbers, if there were a predominant number of provinces, for

no other reason than I have pointed out, the inability of the provinces to tax certain property which is historically property within the province -- I would like to hope that if one of the dissenting provinces was told they could transfer the burden of administration cost to the Federal Government in exchange for the right of the Federal Government to tax something which they couldn't tax that might have subsequent persuasion.

MR. COYNE: It might be a very powerful incentive. Just one final question on this: Would you see any objection in a scheme of this kind if the provinces had varying rates of taxes, as indeed they have now under the various Income Tax Acts -- the Act would have to be uniform but do the rates have to be the same in your scheme?

MR. BAIRN: In order to make the scheme workable they wouldn't have to be. I would refer you to what we say in the brief, taking the broadest outlook of the purpose of this Statutes we believe that in a Federal States such as Canada the impact of death duties should be relatively uniform across the country and certainly we do not think there should be tax havens established within the country with respect to this level of taxation, this mode of taxation.

MR. COYNE: I don't think I have any questions on your next section concerning the taxation of non-resident estates. You suggest it would be desirable for other countries to tax non-residents in the same way and for the Government of Canada to arrange this on a reciprocal basis.

Going on to your recommendation in connection with charitable gifts which you deal with starting on page 43 you criticize the 1960 amendment to Section 7(1)(d)(i) of the Federal Estate Tax Act which provides that "charitable gifts must be absolute and indefeasible."

As you point out this becomes a difficulty where there is an ultimate charitable gift, but on a trust basis but with the right of encroachment in the meantime for the benefit of the widow. I think the recommendation here is quite clear, but let me ask you this: would you foresee any difficulty of an administrative nature if your recommendation was adopted? Your recommendation as I understand it is that you recommend an exemption in the first instance on the amount of the apparent charitable gifts, and if there was an encroachment in the lifetime of the life tenant there would have to be a requirement of taxes and additional taxes paid.

MR. BURN: It does introduce an additional administrative factor. We in Ontario have been living with a similar factor for a good many years now where there is a difference in rules because of differences in relationship and it is fairly common that you might have a life interest to a widow and gift to collateral beneficiaries not blood relatives. If there is a right to encroach in such cases the Ontario Government requires us to report from time to time if there have been any encroachments.

MR. COYNE: Tell me, does the Government, do they circularize executors of such estates from time to ask this information?

PS

MR. BURN: They do, and they also put executors on notice at the time the assessment is issued that they distribute the estate at their peril.

I might point out that the Ontario Act has no compromise provision in it. There is no area of discretion left to the administrators of the Act. I presume it is in the new Estate Tax Act. It was in the old Dominion Succession Duty Act when I was more actively engaged in this phase of work. Speaking from the viewpoint of the professional executors, at that time we would sit down with the Departmental officials and make an honest appraisal of what we thought the needs might be over the lifetime of a widow, in terms of revenue. I think any deviation from those projected needs would be insignificant and they would base their assessment on the joint estimate of what the needs would be in the future, and that would be a final and definitive assessment.

MR. COYNE: Even assuming that that type of compromise, if you like, was not acceptable, is there any reason, in your view, why the Federal Estate Tax laws could not take account of the administrative -- would have difficulty in taking account administratively of these encroachment problems which the Ontario Succession Duty people are dealing with now under their Statute? Would there be any difference, in principle, between the two problems?

MR. BURN: Would there be any difference?

MR. COYNE: Yes.

MR. BURN: No. If I understand you correctly,

the Dominion could do it on exactly the same basis as Ontario is doing it. What I perhaps tried to suggest was that the trouble was hardly worth the rewards. That is the use of the discretionary clause.

MR. COYNE: Does Quebec have equivalent provisions of this nature, to Ontario?

MR. ALLISON: No, because under the Quebec Act a person who is left a life income is taxed as if they received the funds in ownership.

MR. COYNE: Can you tell us what the provisions are in the Succession Duty Act, from the Ontario Succession Duty Act in relation to this problem that you put forward here? In other words, if the type of bequest that you describe in section 3.73 is made in Ontario, does the Ontario Succession Duty Act recognize the gift to the charity for purposes of exemption?

MR. BURN: They would recognize the gift to charities and do what I have suggested, of continuing assessment if there were encroachment.

MR. COYNE: In the same way as where there is a shift as a result of encroachment as between two classes of beneficiaries, which would adjust the rate?

MR. BURN: Yes.

COMMISSIONER GRANT: May I just interrupt there and say that representations were made to us when we were sitting in Toronto on this very point and I am under the impression, Mr. Burn, that we were told at that time that there was provision under the Ontario Act whereby a bond could be established and placed with the Department, which was satisfactory to the Department,

which would permit the estate to be administered, in accordance with the terms of the will, and that on the death of the life tenant, then the matter was assessed upon the basis of what was left and what went to charity.

MR. BURN: Certainly the bond falls within our experience. I have never seen an ultimate accounting of duty deferred until the death of the life tenant. They collect interest on it, anyway.

MR. COYNE: Just turning then to your second point on this question of charitable gifts, you take issue with the view which I think the Department of National Revenue takes by paragraph 7(1)(b)(1), their view being to the effect that a charitable organization, qualified to accept tax exemption gifts, does not include a charitable trust, a trust not being an organization and you not only express a contrary view as to the meaning of the law, you point out the law should be clarified. There should not be this distinction. Quite frankly it is a distinction which has always puzzled me as to why this was drawn.

Do you know of any reason in principle why a charitable trust should be treated any different from a charitable organization for purposes of estate taxes?

MR. BURN: Well Mr. Coyne I think that that is the point. That they do not acknowledge that a charitable trust is an organization.

MR. COYNE: Exactly, but why should they be treated differently? You say they should not be treated differently?

MR. BURN: Yes.

MR. COYNE: I know you want to get rid of the distinction here. I want to know if you know anything about the thinking on the other side?

MR. BURN: No. The only thinking I can think of is the administration by the Department. It is inherent in their duty to collect the maximum tax within the framework of the Act and as they have read the Act, they don't think a charitable trust is exempt.

MR. COYNE: Then passing to the next point, which has to do with Section 26 of the Estate Tax Act, I think your recommendation is perfectly clear. Section 26 provides that in determining the value of any property, no allowance or deduction shall be made for, or on account of income tax, although you make the point that certainly potential income tax liability is in fact a factor that affects the value of property. You suggest this be changed, should be amended to state explicitly that the right to receive future income shall be valued without regard to income tax.

Now do you have any views in connection with, for example, the cost of disposition of property which is not presently taken into account for valuation purposes under the Estate Tax Act? In principle is this very much the same sort of thing as income tax?

MR. BURN: You mean to say real estate, broker's commission?

MR. COYLE: Yes, and other expenses that have to be necessarily incurred if the asset is to be disposed of?

MR. BURN: Well may I suggest that -- I will tell

you what we did sir: we compiled a very imposing list of expenses which we thought, in equity, should be allowed, Surrogate Court fees, lawyers' costs, brokerage costs, real estate, finally came to the conclusion that if all those were included, there would just be an appropriate increase in the rates to offset the deductions allowed to each estate, but those expenses are not of the same order, what we think of in terms of income tax.

MR. COYNE: You don't regard them as being problems of the same magnitude?

MR. BURN: Yes, that is correct.

MR. COYNE: This is why, I presume, you have ignored the other factor in your brief?

MR. BURN: Yes.

MR. COYNE: And then you make another recommendation having to do with the special rules affecting valuation, specifically with respect to Section 28, under which, as I understand it, even though the decedent may have a minority interest in a corporation, if he and close relatives together have a controlling interest, his shares are valued as if they were a controlling interest.

You recommend that this Section be repealed and that there be substituted a Section which would exempt from the normal definition of fair market value any security holding where either the executors or the Department could adduce evidence that the quoted value did not reflect the true market value.

Now just looking, for a moment, at the present Section 28, my first impression in reading the

section of your brief dealing with this matter was that this was a rebuttable presumption. In other words, if the decedent and the brothers owned a controlling interest, that within Section 28 at the moment this presumption of control can be rebutted. That Section says that the results complained of will flow unless it is established that the deceased and such one or more other persons were persons dealing with each other at arms' length.

Now doesn't that sort of provision, if it means what perhaps I am assuming it means, by and large may be what you are making in your recommendation which is, in effect, that one should look at the facts of control rather than some arbitrary presumption?

The presumption is, it can, as I read it, it can be rebutted if the facts demonstrate that though members of the same family, have indeed dealt at arms' length and do not constitute a controlling group.

MR. BURN: I think your point is quite correct. I think possibly we have slurred over it. While the avenue of rebuttal is there, I suggest that it is practically impossible to establish because of the case law which flows -- the Statute which flows under the Income Tax Act, particularly where brother and sister are dealing at arms' length.

MR. COYNE: If that is so, wouldn't it be equally difficult, under your proposal which you had not set out in any detail, to adduce evidence that the quoted value did not reflect the true market value? In other words, don't you think this is a problem of

proof in almost any set of circumstances or any type of legislation?

MR. BURN: Well you do have the problem of proof, but in what I am proposing, my examples are broader, you can introduce external proof in a degree -- in the first case, I would suggest that the measure of evidence, to a large extent, is dependent upon the state of the parties themselves and that is an entirely different matter from introducing a broker as a witness who says yes, on the date of death the quoted value of this security was 75 cents -- I am thinking of a penny mining stock, but under no possible circumstances could you have marketed 250,000 shares at that price because there simply was not the demand for the stock.

If you had attempted to market that stock, you would have broken the market through to 40 cents.

MR. WELLS: You are dealing with another question, Mr. Burn. Mr. Coyne is dealing with, I think, this question of ownership by family.

MR. COYNE: Well yes, and perhaps I have been a little confused here. You really criticize in particular the present Section 28, raising this presumption as to control by a family group. Are you really suggesting, simply, that that whole concept be got out of the way? In other words, far from there being a presumption, such as exists at the moment, if the decedent in fact only owned a minority interest, then in no circumstances could his shares be valued as though there was a control?

MR. BURN: No, because we bring some things back to the Department in our later recommendation. I

think what we are trying to say is this: here is one case which is one case where the Act removes, from quoted value, a security and we are saying there are possibly many cases where the quoted value does not represent a true disposable value to the executor. In some cases it may be higher, in some cases it may be lower so in any of those circumstances, we suggest there should be an exception from, say, standard definition of fair market value and it would be open, in the case if this Section were removed and the other were put it, it would be open to the Department to say well this only represents five per cent of the company, the brother owns 65 per cent so it, in fact, is part of the majority holding and is worth more than the quoted value of the security.

MR. WELLS: Correct me if I am wrong Mr. Burn, are you thinking of a situation where one brother may own -- the family owns the company but one brother may be in a position to deliver control, actual control himself and there have been such instances where the brother has sold control without giving the rest of the members of the family the benefit of the price received?

MR. COYNE: I can understand. What you are recommending is that if, as a result of circumstances of control, it can be alleged a security has some other value than its quoted value, assuming that it is a quoted security, then there should be opportunities for the true value to be determined, rather than for a different assumption to be made. You are dealing there, as I understand it, with quoted securities. What about the situation, which is perhaps more apt in relation to

Section 28, where the securities are not quoted? What is the effect of your recommendation on, let us say, a private company where the decedent has a minority position in the company and his brothers and sisters have control?

MR. BURNS: I would suggest that our recommendation does not flow to that situation at all, because you have the situation where you have had the same factors, but you have not a Statutory presumption against you, in that case. In other words, if you cannot settle with the Department, you can go into court and quarrel with them, but they cannot quote Section 28 at you.

MR. COYNE: So your quarrel is basically with the Statutory presumption?

MR. BURN: Yes.

MR. COYNE: You do not quarrel with what the facts may in fact establish. It's the Statutory presumption and you do not feel, I think you said in answer to my question, that the existing provision which appears to contemplate a rebutting of that presumption, really meets the circumstances. Is that fair?

MR. BURN: That is fair, although my opinion might be questioned, I might say that. My opinion, on further examination might be questioned but that would be my opinion, that the opportunities of rebutting that presumption are very very limited.

MR. WELLS: I must say, I was of the impression in reading this, you were trying to get at that very thing: the situation arises in connection with private companies where you do not have the benefit

of quoted market value. You have to establish value in relation to other similar situations and very often controlling interest will be valued at a higher ratio to earnings, for example, than it would be if it were not a controlling interest and I thought that that is really what you were trying to get at.

MR. BURN: No, Mr. Wells. The factual situation I actually had in mind is where there had been a conversion of a private company into a public company with a partial distribution of stock and perhaps control still remaining in the hands of the members of a family but the bulk of the control rests with, say, one person and other members of the family having relatively small interests.

COMMISSION GRANT: In other words, Mr.Burn, you are taking the case where a deceased has an interest in a private company which could be roughly a 20 per cent interest but in his lifetime, in an effort to avoid or to cut down on his tax liability, he has been gifting his shares until one of his sons, who is associated with him in the business, has acquired 35 per cent of the stock and let us say the other 45 per cent is held among perhaps members of his family or among certain employees of the company.

Now on the death of the father, the son decided that I think I will get out of this business, and he makes a deal whereby he sells his 35 per cent interest and that may be all that the buyer wants to take. Therefore, the Department is liable to fix the value of the father's shares, the deceased shares at the

same price as what the son got for his?

MR. BURN: That is quite so, Mr. Grant, because we are not really dealing with a private company. The case I am really thinking of is the case where the father has made available, I will use simple per cents, 45 per cent of the stock of what was formerly a private company to the public, and it is listed on the Stock Exchange. He has gifted 51 per cent to his son and four per cent to his daughter, and the daughter dies and that stock is quoted at $30 a share.

Now I suggest that all the daughter's estate is is so many shares of stock at $30 a share. However, it is open to the Department to say--oh no that is not so because my arithmetic hasn't been good --

48 per cent, or seven per cent plus or your 48 per cent control of that company and a buyer would pay more for it. As an example, as you very rightly pointed out this is open to the son willing to sell his 48 per cent at that inflated price without regard to his sister's holdings at all. There is no reason why hercestate should be penalized because of the inherent value in her brother's shares.

MR. COYNE: Well this presumes Section 28 repealed and it is then on the number of shares to be bought and that is a difficult thing to do.

THE CHAIRMAN: Mr. Burn, paragraph 3.81, as I read this recommendation to cancel Section 28 it is to permit the executors or the Department to show that the quoted value for listed stock is not true market value. That is a pretty broad implication, I would think.

MR. BURN: Yes, there is a particular Section in the Ontario Act which attempts to deal with this problem, although some people may say it doesn't go far enough:

"Provided that this clause doesn't
"apply where there is not sufficiently
"wide-spread distribution of the securities
"of which such security forms a part to
"reflect the true value thereof in such
"prices of quotations or where such prices
"or quotations is or may be a result of
"any manipulations or any exercise of any
"means of influence by control."

That is one situation where they depart from the quoted value. There may be other situations. I think what is more pertinent in our recommendation is that if an executor felt strongly enough about the situation and the alternative valuation rate was available he could avoid a head on collision by disposing of the security inthe meantime in bringing into the estate the value of the amount he received.

Section 3.79 refers to Section 28 and Section 28 deals with minority interest in controlled private corporations.

MR. ALLISON: I think there are specific rules in Section 27, which as I read it are irrevocable which dealing with valuations of listed companies says:

> "This Section does not apply in
> "determining the value of such security
> "through holding a majority of the shares
> "thereof or other voting interest therein
> "or any other manner whatsoever by the
> "deceased, by the deceased and one or more
> "persons connected with him by blood relation-
> "ship, marriage or adoption or by any other
> "person on his of their behalf".

In listed companies the control factor is irrevocable in Section 28, and although it doesn't specifically so say by inference 28 must deal with unquoted securities, private companies. Our difficultyis with the arrangement at arm's length. It has been our experience unless you can actually establish that a brother or two brothers are, in fact not talking to each other and

haven't talked to each other for ten years, the mere fact they are brothers they are presumed to deal, not at arm's length.

MR. COYNE: By the Department. There is not much jurisprudence on it.

MR. ALLISON: No.

MR. COYNE: You are suggesting that Section 28 be repealed but also that Section 27 . . .

MR. ALLISON: As well.

MR. COYNE: Be repealed and be replaced by the type of position that you are speaking of in paragraph 3.81; is that true?

MR. BURN: I am sorry I didn't catch that figure. We were in error.

MR. COYNE: I have no questions on your alternative valuation date proposal which is quite clear. I really just have one general question on the concluding part in which you comment in response to a request of the Commission upon the problems of succession duties and foreign ownership. You say you would like to emphasize that this observation is based on our collective experience and not statistical information. I take it there just isn't any statistical information that would be available or you have found available to your Association. It has been suggested to me by the research people of the Commission that there might be available to you factual information relating to cases that might be of some value. You are the people who have the information. Is there any study on this question -- do you think there might be some helpful information that you could assemble

without great difficulty?

THE CHAIRMAN: I might add to that this matter is of considerable importance to us. We keep on getting expressions of opinion but they are not very well supported. I can't think of any people who are in a better position than yourselves to know the facts.

MR. BURN: I am going to ask the other gentlemen at the table to comment. On the basis of my experience in the difficulty of obtaining for you what you call factual information, this is more commonly dealt with as estate planning problem rather than as administrative problem and you don't keep records on the estate planning advice. This is a matter which in most cases is worked out in a man's lifetime. He either determines to hold on and take the necessary steps to ensure his estate will be liquid or takes some measures during his lifetime because he has the tools available to him which are sometimes not available to executors such as he could lock in continuing management with a buy-out agreement or something of that nature. Ken?

MR. ALLISON: I think, Mr. Chairman, the question of whether it tends to increasing foreign ownership is very difficult to establish. There is no doubt in my experience that the succession duty facing business owners leads people either to attempt to convert their private company to a public company or by thereby liberating some of their capital or to attempt to sell out. When it comes to selling out it is the question of the highest bidder normally gets it

and you will get certain categories of industries and sizes of industry that are more attractive to foreign ownership than others. Succession duty in itself, I would say offhand by itself doesn't lead to foreign ownership. It leads to the necessity to sell. Having that necessity created it is where the market is and it varies from industry to industry, type to type.

THE CHAIRMAN: Might I interrupt, Mr. Coyne. The necessity to sell is perhaps just what we are looking for. You say pretty fairly, I think, that succession duties really haven't caused a lot of private companies to be sold. That is right?

MR. ALLISON: Yes.

THE CHAIRMAN: Again we haven't been able to secure much support for that. A while ago I thought it might be useful to take a list of all private companies which had been sold in the last two years and see whether it would be possible to run those down as to reasons, finding out to what extent succession duties had influenced the judgment of the vendor. Again I suspect that a lot have been sold because of estate planning, because of the breaking up of estates forother reasons. I wonder to what extent these that had been sold had been because of succession duties?

MR. ALLISON: I think it is a matter of timing. Succesion duties in my experience is not the sole deciding factor. It is sometimes a factor which perhaps precipitates a sale a little earlier than ordinarily would be the case, but a man who is in business and his beneficiaries and actively interested in it can

usually, in my experience, scramble around via insurance, via leasebacks, via mortgages or somehow to raise the necessary cash provided he starts early enough to get sufficient liquid funds. I think sometimes succession duty gives rise to a sale earlier than would ordinary take place, such as when a man retired or when he dies. I don't know whether Mr. Wells would agree with this.

MR. WELLS: I can think of one case and if I racked my mind I could probably think of many others where in planning and estate the owners have seen fit to go public. That, of course, exposes the company to a foreign takeover. I can't think of any case, offhand, where an owner has actually negotiated a sale to a foreign company for purposes of succession duties. I think the point has been made, and I think it is valid that the succession duty problem so often gets owners of private companies to list their stock and that means -- sell it out completely in some instances and that can lead to foreign takeover.

THE CHAIRMAN: Thank you. Supposing we stop at this point and we will come back to it after lunch. I would like time to think during lunch anyway. We will adjourn to 2:15.

---LUNCHEON ADJOURNMENT.

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---Following luncheon adjournment.

THE CHAIRMAN: Are you all ready? I think we might proceed. We were discussing the sale of companies perhaps to foreign interests because of estate taxes, and I think we got to the point where you indicated that you believed that there were some instances where companies had been sold, private companies -- I think we were restricting it to private companies to meet death duties.

We have heard it said that it has been necessary to do this from time to time. Even though the money might be available in the companies, it is not possible to get the money out of the companies. I would have thought, since the Ives legislation, and since everybody became thoroughly acquainted with surplus stripping at no cost, that the problem might have ceased to exist. Do you think there is any need, while there is money within the companies, to have to sell companies in order to raise money to pay their death duties because they cannot get the monies out of the companies?

MR. WELLS: I think there have been instances in the past, since we put it that way. It may be that the situation that existed back years ago does not obtain at the present time. I would like to volunteer, on the part of our Association that we will do a certain amount of research in that and if we have anything to support our observations, we will submit it.

THE CHAIRMAN: That would be very helpful to us. I wish you would because, as I say, we are curious about

with being represented to us that succession duties are causing people to sell companies, and the companies are moving over to foreign owners. We have found very little support, so far, except pretty broad statements to the effect that succession duties are really having such results. If you could give us any help along this line, we would be very grateful to you because we think you must be in as good a position as anybody to be able to appraise this.

MR. WELLS: We won't promise what we will come up with, but we will do the research.

THE CHAIRMAN: That is fair enough, thank you.

COMMISSIONER GRANT: Also, Mr. Chairman, do we not think that it is material to our consideration as to whether or not some companies have been sold to Canadian enterprises? Not necessarily to foreign countries. In other words, the forced sale of companies to meet their succession duty obligations?

MR. WELLS: I don't think there is any doubt whatever that the companies have been sold or put on the market for succession duty reasons. Whether they have ended up in foreign ownership is another question. We could research that, I think.

THE CHAIRMAN: I think Mr. Coyne has completed his questioning with regard to death taxes. Have you anything you would like to ask?

COMMISSIONER WALLS: I have just two questions. The first was that I understand your recommendation is that we turn over the estate tax to the Provinces, with the Federal Government to be the collector. Now this,

if I am correct, is contrary to previous recommendations that have been made from time to time, that it be turned over to the Provinces to collect their own and I would ask is it because of the jurisdictional problems that the Provinces may not be able to enter directly into treaties with foreign governments, or is it principally because of your fear of the use of tax havens that you oppose the idea of it being turned over to the Provinces, to collect the tax?

MR. BURN: No. I would say the fear of tax havens is somewhat remote sir. I think the principle of uniformity can much more readily be established when there is one central body. I am not under-estimating the factor of accessibility to foreign assets, and perhaps the administrative skill of the Federal Government Department has increased so much in recent years the ideas are not so repugnant to us now.

COMMISSIONER WALLS: Would it not be possible for the Federal Government only to act as the agent for the Provinces in dealing with foreign treaties?

MR. BURN: Yes, that is so but you still run into your conflict of property which might be situated in one province and owned in another province and transmitted in another province. You have to overcome those problems.

COMMISSIONER WALLS: So in effect, even if a Province were to set up their own collection, you would have to arrive at some degree of uniformity, as you probably would have to with the Federal Government

becoming the sole collection agency for them?

MR. BURN: I didn't think it would be, no.

COMMISSIONER WALLS: Now I was very interested in your suggestion regarding the collection of estate taxes, and particularly as to how you would apply it to pension funds, and again I am going to deal with another suggestion that has been made to this Commission and I would like to get your reaction because it seems to me it might remove most of the problem with respect to the valuation of pensions and annuities and that is that the estate tax only be collected on the death of the last survivor spouse.

In other words, that the estate be considered to be the amassing of worldly goods by husband and wife and that, therefore, estate taxes only be due when the last survivor dies.

MR. BURN: We considered that matter in considerable detail, in a theoretical sense, sir. We did not limit the scope of our thinking to pensions. It would fit in with our basic philosophy, regarding what we think the social objective of this tax is, that there would be a great deal of merit in the surviving spouse enjoying the full fruits of what he or she, and his or her spouse had achieved during their lifetime. You immediately run into immense administrative problems, of course. What string are you going to keep on assets to ensure that there are sufficient to pay the duties at the end of the period? I might say this is not part of this submission: We literally considered as to whether the estate tax should be

regarded as an investment of the estate and the widow allowed to have the use of the income which is on some form of deposit with the Federal Government. We eliminated that. We saw a great deal to support the position which you say someone else has expressed but we felt that it bogged down in administrative details.

COMMISSIONER WALLS: If you were to put that system into effect, would you necessarily need to increase the maximum exemption?

MR. BURN: Provided that there was some element of safeguard -- if there were, say, minor children following the death of the last surviving spouse, I suggest it probably would not be necessary.

THE CHAIRMAN: I cannot see what administrative difficulties there would be if one simply took the view that there was no succession whatever until both consorts had died.

MR. BURN: Well, Mr. Chairman, perhaps it ill behooves me to take the position of the Department but you honestly would have to put restrictive measures on gifts, wouldn't you when the second spouse was surviving? Maybe you don't mind so much if she dissipates the estate. Then it comes into the public realm but you wouldn't want her to be able to gift it so that she in fact had no estate. There would be no question of taxes then whatsoever.

THE CHAIRMAN: But surely a tax on gifts is a corollary of estate taxes anyway? One could, I think, develop that. I was a little surprised that you did not speak about the gift tax provisions in the

Income Tax Act. It seems to me there should be some correlation between the two because I would think that death taxes would be perfectly useless if one was not in some way restricted by tax on giving away his money and, therefore, I would assume that what is inserted now would continue to be inserted. That is all.

MR. BURN: I don't know whether I have gathered the import ---

THE CHAIRMAN: You said you would need some provisions with regard to gifting in order that the widow, if it were a widow, could not give away all the money that had passed to her but I say to you that those provisions are now inserted in our Income Tax Act.

MR. BURN: With fairly liberal exemptions which, over a period of years, can amount to something -- it has always been my view, sir, that the gift tax provisions, there are an acknowledgment people are going to make gifts who do not, theoretically, fit in with the concept of death taxes.

THE CHAIRMAN: I am sorry, I was assuming that that was not the case; they must deal with death taxes and I was taking too broad a jump at it.

COMMISSIONER GRANT: Another very definite disability in considering such a proposal as this would be: Is it not, Mr. Burn, the fact that you can always have your intentions with regard to control expressed in the will, and it is not every testator that wants his wife to have full control of his estate and she is sometimes given quite a limited control?

MR. BURN: That is so. During the course of our discussion it was suggested to make this administratively feasible, every estate would have to be administered by a trust company.

COMMISSIONER GRANT: You showed commendable restraint in not putting it in the brief.

COMMISSIONER BEAUVAIS: With regard to the exemption for dependents, would you not consider that the definition of dependent should be similar to that as expressed in the Income Tax Act?

MR. BURN: I think there is a great deal of merit in -- if the child is dependent upon the deceased by reason of physical and mental infirmity, graduation is stopped with respect to that child. I think there is considerable merit in that suggestion sir.

COMMISSIONER BEAUVAIS: Not only that, but if a child is independent and is 23, then you would not be subject to that?

MR. BURN: Yes.

COMMISSIONER BEAUVAIS: Now a second point. I refer to page 31, at the end of the first paragraph. You say that:

> "It is our recommendation that a similar provision be inserted in our Federal Tax Act, provided that the exemption granted to the widow be not greater than the benefit received by her."

My question is: Would you consider that she received full benefit when she has only the usufruct, the

life interest from the estate?

MR. BURN: We would. I suppose that you could receive a different answer from my friend from Quebec here than you can from me.

COMMISSIONER BEAUVAIS: Could I have both answers?

MR. BURN: My quick approach would be the actuarial value would determine, that is to actuarialy determine a life interest. I believe sir that that is the procedure in the United States of America where they grant a marital exemption, and, of course, I am really answering your question -- we point out what we think is an anomaly in the present Act; that restriction does not apply.

COMMISSIONER BEAUVAIS: And in Quebec, I suppose she would pay a tax on the full amount. She has the full benefit.

MR. ALLISON: She would pay tax on the whole amount on Quebec succession duty. Duties would be really restricted to the income. I believe I am right in saying in U.S. law, where you have this life interest proposition, in order to get the maritall exemption, there must be the ability for the widow to demand all or a portion of the capital from which she is receiving the income. Just a straight life interest, the widow has to have something, really, either a bequest or on her more or less demand to receive capital.

COMMISSIONER BEAUVAIS: Because what you say here, the benefit received by her, you have to establish the benefit.

MR. COYNE: Now the last point is the remarriage clause that you talked about this morning. If a pension ceases upon remarriage, would the payment of the duties cease, as in the case of the death of a widow, for instance?

MR. BURN: Yes, sir.

MR. COYNE: That would be the same treatment?

MR. BURN: Yes.

THE CHAIRMAN: Going to your table opposite page 37, where you compute what the taxes would be, having regard to the rules that you propose as to exemption, you put the total amount of taxes at $36,735,000.00, and the average tax is 7 per cent as against the present average of 15.9 per cent. My question would be that if these exemptions, as you suggest, were accepted, thought to be an excellent plan but the Minister simply took the view that we should still receive $83 million or $85 million, whatever it might be, and that the variable was not the amount of tax, the variable was the rates would be adjusted in proportion to achieve the taxes, now would your exemption still be valid under the higher rates? Would that still be a better rate of tax than with the existing exemptions?

MR. BURN: I will ask my friends to feel free to disagree or check my answer, but I suggest that our position would be that if it were necessary to raise the same amount of revenue, we would find favour in extending the exemptions, as we have proposed them because, in fact, you are then favouring the people

who are closest to the deceased and I think it would be our feeling that this would be a desirable objective.

THE CHAIRMAN: Thank you very much. I duly note your recommendation is not to do that but thank you for answering that question which I think is significant. One more question.

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Are there any steps essential to pick up the revenue -- I suppose they are also there to pick up revenue which would be imposed under death taxes because of inter vivos gifts. I suspect that even with those gift taxes that inter vivos gifts might be said to represent a loophole in the succession duty, although perhaps that is a bit exaggerated because there is a tax on succession. There is a tax at death, but certainly if one could give away one's money freely there would be no tax. You would never collect a tax at death, so to that extent I would think that gifts are a loophole unless the tax on gifts are equal to the tax at death. I would suspect that Canadian taxes on gifts are not equal at all times to the tax on death, but I haven't calculated it. I don't know whether one could work it out and say whether they are equal. Would you think that there is a fair degree of equality between gift taxes and death taxes so that the taxes tend to be neutral and so there is not a very substantial advantage to give away your money prior to death.

MR. BURNS: It all depends on the size of the estate.

THE CHAIRMAN: I suppose.

MR. WELLS: Very wealthy people who anticipate death and give their estate away -- I think that really answers your question.

THE CHAIRMAN: I think it does. It goes part way to answer it anyhow. I suppose the next matter one must be concerned about would be the possibility to achieve a tax taking into effect the size of estates,

into consideration the size of the estates so there wouldn't be an advantage, substantial advantage to gifts.

MR. WELLS: I suppose the ability to give money away during their lifetime at a low rate of taxes accomplishes the social objective that is implicit in the Succession Duty Act.

THE CHAIRMAN: I have some views about that. That is a partial answer anyhow. It divests the prospective testatorof some of his money, but it doesn't spread it around the whole populas. It gives to his own family.

MR. ALLISON: I gather, Mr. Chairman, you are referring to the comparison of death tax rates versus succession duty rates. I think in any consideration of how close these two may be brought together one must keep in mind that this tax is prepayment of succession duties. The length of time by which the amount is prepaid is the governing factor of how close to equality the rates may be. If you prepay twenty years in advance it means the government has had the use for twenty years and the testator hasn't.

THE CHAIRMAN: You may have noticed it was proposed to us by Mr. Neaman in Winnipeg there should be some means of prepaying one's estate tax. Perhaps that is what gift tax seeks to do. If it does do it shouldn't there be a better relationship between the gift tax and the estate tax? It seems to me there is so much in favour of going in one direction it must be a tremendous incentive to certain people to choose that group. I wonder if there has been a study of this

at any time. I am not aware of it.

MR. BURN: I am not stating this on behalf of the Association, but I might direct your mind to a survey that propounded, -- the Tax Association Convention proposed this, seven or eight years ago where it was suggested that the rates of tax be progressively based on the aggregate gifts received by receipients from whatever source. That is a suggestion as to how the problem might be tackled.

THE CHAIRMAN: It has just been pointed out to me that the gift tax was first imposed in 1935 six years before the Succession Duty Act which may be significant.

MR. GRANT: Before the Federal Succession Duty Act?

THE CHAIRMAN: Yes, before the Federal Succession duty Act.

MR. GRANT: Might we pursue a little further, Mr. Burn, the matter raised on page 44, 3.75 with respect to the charitable trust versus the charitable organization. Perhaps if we are to make any recommendation on that we should have a little more information. I am under the impression that where a testator sets aside a certain sum of money and directs his executor and trustee to pay the income to charities of their choice, that that is where this problem arises. Just for the sake of saving time, if I may develop my thought on it: It seems to me that one of the problems that we are confronted with there is the definition of charity because under the Act "charity" is a definite

thing and it is known what it is. When it is named then there is no question about it. The authorities can say this is a charitable organization and as such that qualifies. When it is not named, when it is left to the discretion of the executors and the trustees they may choose an organization which in their opinion is a charitable organization carrying out charitable work but which in the eyes of the law is not recognized as a charity. Is that part of the problem, or is that the problem?

MR. BURNS: There is a very classic definition of charity in English law, sir, and I don't consider that part of the problem, because I would think that as a trustee who made a gift to a charity which didn't as a matter of trusteeship, didn't qualify within that definition, and as I understand it the definition would be the same in the Estate Tax Act he would commit a breach of the trust.

COMMISSIONER GRANT: Well now, to be specific I am thinking of a case where trustees carrying out their directions under a will say we will allot so much of the income from this fund to say a fraternal organization which is carrying out charitable work, and they may say we earmarked that for charitable work and the fraternal organization is not regarded as a charity within the meaning of the Act and therefore the authorities, the Estate Tax authorities cannot recognize that as a charitable gift.

MR. BURN: Will you just give me a second, please?

COMMISSIONER GRANT: If you would like to submit further information to us at a later date on that point, I think we would be very happy to receive it.

MR. ALLISON: Perhaps Mr. Grant I could offer one actual illustration we have in the past in the old succession duty: A man had created and specified a trust with authorization to the trustees to use the money for charitable purposes, to make gifts or grants to charitable organizations in Canada. When the Estate Tax Act came in this did not qualify as a charitable organization and we incorporated a charitable foundation the members of which are now two members of the deceased's family plus officers of the Montreal Trust Company and we are carrying on that foundation, in fact as a trust to comply with the provisions of the Estate Tax Act. There was the necessary expense of incorporating the foundation and the necessary expense of keeping it alive when in fact the charter power and everything are identical to the man's previous will. This is the point we are making. I think a foundation to a certain extent being administered by individual members is, perhaps, more susceptible to abuse than a trust where the trustees are obliged to account. This is the type of thing where we can't see the advantages.

COMMISSIONER GRANT: You can circumvent the law by incorporating under the Charters Act or some similar legislation.

MR. ALLISON: Under the Federal -- that is right.

COMMISSIONER GRANT: In your case it was large enough to go ahead with that.

MR. ALLISON: Yes.

COMMISSIONER GRANT: There are lots of cases where it wouldn't be large enough.

MR. ALLISON: Yes. The second difficulty that we run up against in mentioning specific institutes is the uncertainty that either these institutes will be in existence twenty years from now or that they will have any particular needs for funds. These might be diverted elsewhere. This is why you have to get a broad terminology for the trustee to select.

COMMISSIONER GRANT: Thank you very much. I am satisfied with the explanation and I think that this is becoming more prevalent under wills whereby the executors and trustees are charged with these responsibilities of choosing their charities.

MR. WELLS: Perhaps the point could be covered if the legislation were clarified to the extent of granting these exemptions where the discretion was exercised in favour of charities that did qualify.

COMMISSIONER GRANT: Yes.

MR. COYNE: Which is more or less the way with the Income Tax Act.

MR. ALLISON: The other factor is that under the Act the charitable organization must have well defined rules and regulations otherwise it looses its tax free status.

THE CHAIRMAN: That was going through my mind,

this relationship with the other Act. That could be looked at. It might be helpful to us. You gentlemen would like to get away in forty minutes. We will do our best. In fact we will succeed. Mr. Coyne.

MR. COYNE: Mr. Chairman, I think we can move on now to the third section of the Association brief containing general comments on taxation. Apart from the hints about time I must say I don't have as many or as detailed questions on this section as on the other, although you may wish to develop the discussion.

THE CHAIRMAN: What page?

MR. COYNE: It starts at page 50.

THE CHAIRMAN: Thank you.

MR. COYNE: After some general remarks about the problem of Canadian security ownership and the constant pressure of foreign buying of Canadian equities and that sort of thing you go into a discussion that leads to two specific recommendations. Your discussion starts in paragraph 4.06 on page 52 in which you describe the limitation of equity investments which are now imposed on trust companies by the regulatory legislation. As I understand your description you are speaking here of guaranteed funds and your own funds, not ordinary administrative funds. There are two types of limitations. One is a quantity limitation, if you like, in a sense you are limited to 15 per cent of such funds as equity investments and there is secondly a quality limitation based upon essentially the dividend records of the companies which have issued the shares. You suggest that the quantity limitation

is not a significant one but that quality limitation is. You then go on to specifically make the respresentations that these quality limitations be liberalized so that there will be broader opportunities for trust companies to invest in broader range of equity investments, presumably equity investments which carry more risk, speaking broadly, than the investments that are now available to you.

MR. SMITH: Or new ventures that haven't established a performance.

MR. COYNE: Or new ventures that haven't any performance record.

MR. SMITH: That is right.

MR. COYNE: Now, you couple with your recommendation that these equity limitations be liberalized the collorary that you should also under the Income Tax Act be permitted to set up a tax free reserve to protect against, protect you against loss in such investment. The first question I would like to ask related to this reserve suggestion, and it is somewhat analogous to our discussion this morning of mortgage reserves, is it your suggestion that this setting up of a tax reserve be only available to trust companies or would it have to be available in one way or another to other companies, other institutional investors, if you like, who might be investing in this type of security?

MR. BURN: Before I directly answer your question, I don't know whether it is coming out in the context, but our intention here was perhaps these

recommendations not be perhaps as firm as some of the other recommendations in some of the other parts of our brief. We in fact, try to look at ourselves objectively and especially now there is a great deal of discussion about the problem. We don't know the seriousness or the extent of the problem. It never really has been defined, but if it is the view of the Commission that this is a problem here are some of the tools which might increase the extent of our investment in the equity field so, in that context we are obviously just speaking of ourselves.

MR. COYNE: As far as yourselves are concerned you express the view that these recommendations if put into effect would be an incentive to you to increase your equity investment.

MR. BURN: It is possible that they would be.

MR. COYNE: Would you go more than that, do you think it would? Would you go further than that? Do you think it would be an incentive?

MR. BURN: I think perhaps the discussion might be very topical now. In addition to the reserve it appears that there may be a marketing of securities up to the extent of 25 per cent of what formally had been solely owned subsidiaries of American companies. We have seen a slight indication, one or two examples recently, and we don't know the extent to which that will extend.

MR.COYNE: As a result of the proposed tax change in the budget.

MR. BURN: Yes. It may be that these companies

have no dividend record for various good reasons, that they have re-employed capital in the company and the parent hasn't needed money, but they might have steady earning record. Obviously there is no particular justice achieved in the budget if a large portion of the 25 per cent flows across the border. One possible impediment to that would be to give us capacity and encouragement to participate in these new issues.

MR. COYNE: I realize you couple the two things together, the incentive to increase your participation in this field and at the same time give you the opportunity by liberalizing the trust company legislation.

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Supposing; instead of being coupled like that those were divorced and no tax free reserve was provided for but the trust company legislation was liberalized as, for example, in connection with new enterprises which just simply have no performance experience, what would be your thoughts about that type of change?

MR. BURN: I would suggest that perhaps the limitation on that would be there might be a tendency for companies to invest a portion of their own capital, if they look at a venture, probably not so much in guaranteed funds -- somewhere or other I think we have tried to say today if you invest a portion of your guaranteed funds in a venture like that, you are probably buying a security that is paying a less return than you have to pay the people from whom you are borrowing the money. There has to be some real incentive, I think, to get any appreciable flow of those funds.

MR. WELLS: Would you say, Mr. Burn, that if we had to choose, we would choose the 3 per cent reserve, if you like, liberalized?

MR. BURN: Investment powers also.

MR. COYNE: That leads directly to my next question Mr. Wells, which was this: In your thinking on this reserve, are you thinking in terms of the reserve being available, presumably, on a percentage basis against your whole equity portfolio, or just against those losses in this extended portfolio that you would now be permitted to go into?

MR. WELLS: I think we may reserve against the

whole portfolio.

MR. COYNE: You want both your cake and to eat it as well?

MR. WELLS: Well we are aware that other financial institutions have reserve privileges that we do not enjoy. Trust companies have become much broader in their investment policy, which I think is good for the economy, and we do feel that we are probably entitled, as financial institutions, to some additional reserve.

MR. COYNE: And, of course, in your brief you do relate this suggestion to your mortgage reserve suggestion, I believe?

MR. WELLS: That is right.

MR. COYNE: And, in effect, what it amounts to, when you have said it all, is it would be in effect all the reserves for all your investments?

MR. WELLS: That is right.

MR. COYNE: Of both a mortgage nature and of an equity nature. What about your bonds?

MR. WELLS: I wouldn't even exclude bonds.

THE CHAIRMAN: May I interject here? I was very surprised to have this recommendation. The fact that one has a reserve developed by taxes would not, I would have thought, really have much bearing on one's investment decisions because if one makes foreign investments or if the equity is slightly reduced and the risk is increased, the loss, whether or not one has any reserve, is going to eventually just have the same effect on the profit. The reserve is only going

to be of a temporary nature. The final result is going to be the same, and I am very surprised that this reserve would have any worthwhile effect at all on your management decision as to investments.

MR. BURN: There is a secondary factor that our capacity to accept deposits is based on the sum of the market value of our investments on reserve. That is in capital account, I beg your pardon, just in capital account.

MR. COYNE: If I may supplement that question, and perhaps Mr. Wells wishes to express a view, in effect isn't the effect of the reserve merely shifted, the timing, if there is in fact a loss, merely shifted? The timing of the deduction of that loss in the company accounts? You are going to deduct the loss anyway. If you have set up a reserve, you just deduct it in anticipation of the loss rather than when the loss actually occurs.

MR. WELLS: I would say that it would be very comforting to have -- to be able to be aware of tax free reserves against possible losses. I think we have in mind the fact that the banks are allowed the reserve against losses in their portfolio, not their investment portfolio, probably. As I said, the trust companies are, I think, contributing more through their investment policies towards the general economy than they have in the past. We do incur risks. Confidence is of the essence in trust company business and I don't know that we can be too serious about this, but we do honestly feel that perhaps we are entitled to some

consideration.

THE CHAIRMAN: Now that is a different matter. Fine, thank you. I was looking at it as an incentive for slightly riskier investment and I can't see it.

MR. WELLS: I don't think it was and I don't imagine, to be quite frank, that we will invest very much of guaranteed funds in common stocks. Some trust companies do now, and I think probably properly so but I don't think we are going to solve the economic problems of the country that way.

MR. COYNE: Then if I might just move on to the other recommendations that you make in this connection, I think you deal with them in paragraph 420 on page 57. You say: "This incentive..." and perhaps that incentive, to some extent you have qualified the incentive effect that you would expect from the reserve "could be further strengthened by a change in the treatment for tax purposes accorded to dividends received on such investments".

The way you describe the problem is that only part of the dividends you receive from equity investments are tax free and you are suggesting that they should all be tax free. Am I right in thinking what you are really complaining about there, or suggesting should be changed is the present provision in section 12(1)(c) of the Income Tax Act which prohibits the deduction of expenses which have been incurred for the purpose of earning tax exempt income?

MR. BURN: That is so.

MR. COYNE: That is what you have in mind?

MR. BURN: I am aware of the tone in which it is suggested. If the problem is serious enough, here is an ambit that could be explored.

MR. COYNE: I suppose I can ask my question, if you have considered it. If you are going to, in effect, take away that prohibition that now exists against expenses incurred in earning tax exempt income, would it not necessarily have no extension beyond, let us say, trust companies and receipt by them of tax exempt dividends?

MR. WELLS: I suppose it would have to apply to companies that are engaged in similar type of loaning operations. Wouldn't that be so?

MR. BURN: Yes.

MR. COYNE: As you put it, it would be a specific exception to a general rule that now appears in the Act, and it would work to the benefit of trust companies perhaps exclusively under your recommendation?

MR. WELLS: It would have to apply to loaning companies. It would not apply to insurance companies because they do not work in the same way we do.

MR. COYNE: What about an ordinary company that borrows money to tie up the shares of a subsidiary, for example?

MR. WELLS: I don't think it would have to apply there.

MR. COYNE: Although he is not entitled to deduct the interest he pays on that borrowed money, any income from the shares he receives would be tax

exempt. Would you draw a distinction between lending institutions and that type of transaction?

MR. WELLS: I would.

MR. COYNE: Then going to the next section, which is fairly lengthy, it deals with the question of capital gains. Mr. Chairman, shall I proceed?

THE CHAIRMAN: By all means. Please do.

MR. COYNE: And I would like to ask a few specific questions on specific points in your brief.

THE CHAIRMAN: May I, before you get into that, just make one reference to something I had noted on page 59 as to a simpler definition of income.

MR. COYNE: We haven't got there yet. Do you want to take it on?

THE CHAIRMAN: No, I do not.

MR. COYNE: I mean, perhaps my first question was not more or less what you had in mind.

THE CHAIRMAN: You put it.

MR. COYNE: I was going to invite you to perhaps expand a little on your thinking that you do not want to see any change in the definition of business income for tax purposes and in particular you don't want to see elimination from Section 139(1)(e) of the reference to gains from an adventure in the nature of trade.

The Commission has received other representations, of course, on this general subject and I think I am right in saying that many of the other groups have taken precisely the opposite view; that they feel that the present difficulties arise out of

the definition of business and the inclusion within the definition of adventures in the nature of trade. Is this the subject you had in mind?

THE CHAIRMAN: Not precisely. Carry on.

MR. COYNE: I wonder if you would care to perhaps expand your thinking in this regard, in view of the fact it is different, admittedly different from the views that other people have taken before the Commission?

MR. BURN: I think that what we are trying to convey there is you are being faced perhaps with two choices and that if you narrow the definition of income, you are probably forced into a capital gains position because the nature of one of these would increase.

MR. COYNE: And yet I think you go so far in this -- I cannot turn it up at the moment -- of saying even if there were a capital gains tax you would not be in favour of changing the present definition of income. In other words, for example, these real estate cases that have been so notorious in the last few years and which many people think should have been treated as capital gains have been considered as giving rise to taxable income; As I understand your position it is that even if there were a capital gains tax you would leave those cases as they are at present with those gains taxed at full income rates?

MR. BURN: Yes. It is the Real Estate Cases Act, and I take it when we say real estate acts we are thinking of the same kind, falling within the

concept of income gain as opposed to you thinking of capital gain as a gradual accretion in the value of something you hold, and I see nothing repugnant in our concept of an individual who enters into a business venture with a view to relatively short term profit, he should not be taxed on income basis.

MR. COYNE: Are there any other changes in the present definition of income which you think are desirable? Your brief is silent on the subject.

MR. BURN: The brief is silent on the subject and I suggest that it may not be too material but we ran out of time probably but there is a line of cases where a normal businessman, or perhaps a normal accountant would consider them to be day to day expenses which are excluded as they are not expended for gaining income. I don't know whether I will be able to charge up my expenses for being on this trip or not.

THE CHAIRMAN: Try.

MR. BURN: But there are those lines of cases. We would like to see the statute provide for stock transfer facilities for your shareholders, legal expenses, including additional capital, things of that nature. We would like to see the definition of income closer to the businessman's definition in those respects.

MR. COYNE: I suppose most of the difficulties of this nature arose under the general provisions in Section 12(1)(a) and 1(b) where there is no deduction on account of capital outlay and no deduction of an

expense except to the extent it was incurred for producing income.

MR. BURN: Those are sort of the basket clauses.

MR. COYNE: Does your thinking extend to making any sort of specific recommendation as to how the statute might be amended to meet this difficulty?

MR. BURN: We have not, I am sorry.

THE CHAIRMAN: This might be a good time to acknowledge my debt to the Royal Trust Company for deduction of social club dues. Thank you.

MR. COYNE: But what we can take from what you have said is that you view the non-deuctibility of a number of these expenses as being unfortunate. You think they should be changed but you are not putting before us any specific recommendation as to how the changes should be made?

MR. BURN: No. If I were asked to word it, it would be "expenses allowed in accordance with the general principles of accounting", something of that nature.

MR. COYNE: Then turning to page 60, paragraph 4.29, and you are dealing with the question of capital gains tax at this stage, and you say, in effect, that whatever the theoretical justification one may be able to develop for capital gains, the administrative complexity, in effect, renders such a tax an impractical venture. Does this represent a major feature in your opposition to the theory of capital gains tax? In other words, if the administrative

problems, which you envisage, could be overcome, would you be in favour of a capital gains tax?

MR. BURN: No. May I see if we are on common ground: In 4.29 we specifically speak of the impracticability of taxing anything but realized capital gains.

MR. COYNE: Yes.

MR. BURN: To prove a realized capital gain, there are immense administrative problems which we point out later on are not impossible to solve but which do not alter our viewpoint.

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For a while they could have solved them.

MR. COYNE: Could not it be said you take your position, your theory on capital gains tax independent of the matter of administrative difficulties.

MR. BURN: That is right.

THE CHAIRMAN: Seeing we are running out of time could I interject a couple of questions on capital gains, which this Commission has considerable interest in. I think one concedes the administrative difficulties, the lack of yield -- everybody seems to point to that. There is one, I think, worrisome area, and there may be several, but there is certainly one and I don't know whether it is serious or not. It has been represented to us it may well be serious. There may be people who live on speculative profits or go partway to living on them and that in some cases those may not be taxed. I must say I don't know whether they are taxed or not taxed. Of course, if there are people living on speculative profits escaping tax while it may not amount to anything so far as the revenue implication is concerned it certainly is going to affect other taxpayers who are not living that way and pay taxes, because it is unfair. I would doubt if this is the case with regard to real estate because the Department seems to catch them. You read about the cases in courts where real estate is the cause. I don't see many cases with regard to securities. It may be very hard to get at these. I have found a great many other countries have directed themselves to what they call taxing speculative profits, although

they say they don't tax capital gains and some times they use time like in England, for instance. Certain European countries do. Do you think there is anything to worry about in this area? You think that the information which has been put to us to the effect that there may be people who are escaping tax because of real business transactions is true? I don't know. Perhaps the Act is broad enough to take care of these things. Have you any awareness of that and the need for further legislation and further proof of this thing?

MR. WELLS: If I may speak to that briefly. I have no doubt that capital gains tax would pick up tax revenue that is otherwise lost, and probably equitably. It seems to me that the whole legal and accounting professions become involved in helping people to escape taxes which seems to me a great waste of time, effort and talents. Apart from that doesn't capital gains tax properly come with a more mature economy than ours. It seems in a young country like ours struggling for growth that there is a great deal to be said for allowing people to make capital gains.

THE CHAIRMAN: I am really talking about speculative profit rather than capital gains.

MR. WELLS: Isn't that covered now? There is a capital gains tax in Canada on a speculative profits, surely.

THE CHAIRMAN: I don't know. Is there?

MR. WELLS: If we in Royal Trust engage in trading in securities to make capital gains we would be taxed. As a matter of fact I think most investing

institutions are very conscious of that possibility.

THE CHAIRMAN: So far as the individuals are concerned you are not aware of any great need for anything further in this area.

MR. BURNS: I wouldn't like to answer that categorically, but I believe that the evils that would be created by capital gains tax would probably be about as great as they are at the present time.

THE CHAIRMAN: Anything further on that?

Page 61, 4.31 you say that capital gains taxation would compound this problem by effectively taxing undistributed corporate income a third time to the extent that it is recognized in the sale price of a corporate equity stock sold by a taxpayer. I am a little lost there. I would think that it would tax it a second time. The first time is when it is earned and it is undistributed and because it is undistributed there is no distribution tax. Yes, it is undistributed. There is no distribution tax, therefore it would only be taxed a second time with the capital gains tax. Right now I think it is only taxed once whereas distributed earnings are taxed twice.

MR. FORD: I think that the assumption, there is an underlying assumption in that that ultimately the earnings will be distributed so that the taxation occurs the first time in a corporation and the second time in the transfer of the share price, recognizing distributed earnings, and the third time when the earnings are, in fact, distributed.

THE CHAIRMAN: I understand that premise, Mr. Ford. I don't think it is particularly valid, but I understand the reasons. That is another thing that I have been concerned about, I am not saying the Commission has, because the Commission hasn't formulated any ideas, really as yet, but whether or not undistributed earnings are taxed the same amount as distributed earnings so, in effect, they don't escape from tax. People tell us they escape from tax.

MR. BURN: I might say, sir, we have to veer off of that point because of the revenue implication.

THE CHAIRMAN: Does anybody else have anything on capital gains?

MR. COYNE: That is all I have on capital gains. Do you want to move onto the final section of the brief?

THE CHAIRMAN: I think we had better move on pretty quickly.

MR. COYNE: Perhaps I could just pick up one small point on the capital gains section in paragraph 4.40 at the bottom of page 64. You comment that one of the loopholes in capital gains tax -- this is an example in the United States as far as the theoretical question of equity is concerned is that there is no tax upon the death of the holder of capital assets and, of course, this is the current position in the United States, although as you are no doubt aware the administration is advocating that that be deemen realization on death, and I believe it is very topical in Congress at the moment because they have expressed

opposition to dropping capital gains tax unless this other corollory provision is introduced. Would some of your criticisms of the concept of the capital gains tax, at least on the grounds of proecting these equities disappear if there was a tax that deemed realization at the time of death.

MR. BURNS: While that would make the application more equitable I think that there would obviously would have to be a parallel amendment in our estate duties, even if it is only to the extent that the tax is allowed as a debt certainly not wishing to over-emphasize the administrative aspect if it were seen that the job could be more effectively done with that one axe rather than an axe and a sword.

MR. COYNE: You would express the view generally the Estate Tax Act could be used for this general purpose without necessity for capital gains tax.

MR. BURN: Yes.

MR. COYNE: Turning if we may to a number of what I may call miscellaneous points that you bring up in the concluding part of the brief, the first point starting at page 71 has to do with the rate of tax payable by NRO investment corporations which was hitherto 15 per cent flat rate of tax and which is now proposed to raise to 20 per cent as of December 31st, 1964. You make a specific recommendation which appears on page 72 as to how the rates should be adjusted. I take it that your theory here is that the NRO corporation is merely a conduit and that the

incomes derived from the investment should not be taxed any more heavily if the security happens to be held by NRO than if held by non residents direct.

MR. ALLISON: That is right.

MR. COYNE: And then in paragraph 4.61 immediately following this -- I am sorry, 4.64 on the succeeding page you say:

"A similar provision could be introduced into the Income Tax Act to apply to distributions to non-resident beneficiaries of Canadian Trusts. The effect of the Budget resolutions is that all Canadian dividends and interest passing through a Canadian trust to a non-resident beneficiary are and will be subject to a 15 per cent non-resident beneficiary tax".

Youare not suggesting that the effect of the Budget, that the Budget resolutions have changed this particular rate of tax, the 15 per cent rate you describe.

MR. BURNS: No, put them to disadvantages they wouldn't enjoy if they were direct holders of the securities.

MR. COYNE: Because of the fact that if they were direct holders under the Budget resolutions of certain securities there would be a withholding tax of 10 per cent, withholding tax ultimatelyof 20 per cent.

MR. BURN: Except in the case of a trust I would suggest a large measure of securities would fall within the 10 per cent category.

MR. COYNE: You are really suggesting, and you will correct me if my assumption is wrong in this instance the trusts are in fact to be regarded as a conduit and there should be the same value withholding tax applicable to dividend income that applies through a trust or estate.

MR. BURN: Yes.

COMMISSIONER GRANT: The point being there are more securities that qualify for 10 per cent than for 20 per cent held in trust. I think that is what you brought out.

MR. BURN: Yes, essentially assets in trust for the portfolio securities that would qualify for 10 per cent deduction.

MR. WELLS: Ten or 15 per cent would apply to the underwritten security.

MR. COYNE: Turn the page again, page 74.

THE CHAIRMAN: Are you nearly finished?

MR. COYNE: I will make this the last question, Mr. Chairman. 4.68, composite employee benefit plans. You point out there is a going tendency for employee benefits to fit together in a bunch, so to speak and you say:

"While various portions of such a composite plan would fit within the provisions of the Act relating to that type

of benefit, the plan as a whole would not correspond with any provision in the Income Tax Act. It would be preferable if such composite plans were given statutory sanction so that no question could arise as to the tax treatment of contributions to and benefits received from such plans."

You are not suggesting any further tax relief as such in respect to any particular types, merely that a study of the lots should clarify whether they should bunch together into a single bunch.

MR. BURN: That is right.

MR. COYNE: I have no more questions.

THE CHAIRMAN: Thank you very much. We have no more questions.

It remains but to thank you indeed for this very worthwhile submission and your help today. We are very grateful that you have undertaken to provide even more help on a most important matter to us. Thank you gentlemen very much indeed for appearing today.

MR. WELLS: On behalf of the Association I would also like to thank you, Mr. Chairman, and your colleagues for the opportunity of presenting our views. We will do this research on foreign ownership in connection with succession duties and if there is any additional assistance we can offer

you we will certainly be glad to cooperate.

THE CHAIRMAN: As Mr. Grant suggested rub out the word "foreigh".

We will stand over until 9:30 tomorrow morning.

----ADJOURNMENT.

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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Friday, the 1st day of November, 1963.

C O M M I S S I O N :

MR. KENNETH LeM. CARTER -- Chairman

MR. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

MRS. S.M. MILNE

MR. CHARLES WALLS

COMMISSION COUNSEL:

MR. J.L. STEWART, Q.C.

RESEARCH DIRECTOR:

PROF. D.G. HARTLE

SECRETARY:

MR. G.L. BENNETT

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RPS

---ON COMMENCING AT 9:30 A.M.

THE CHAIRMAN: Even though it is two minutes early, I see no reason why we shouldn't start Mr. Secretary.

THE SECRETARY: All right Mr. Chairman. Mr. Chairman and Commissioners, this morning you have before you a brief being presented by the Association of Canadian Distillers. There are a number of executives of the Association here this morning to speak to the brief, together with Dr. Petrie, the consulting economist for the Association.

Mr. G. Ross Herington, President of the Association, and President of H. Corby Distillery Limited will speak initially. Associated with him is Mr. Maurice Marchand, Vice-President of Melchers Distilleries Limited. Mr. Harry Cox, Secretary and Assistant Treasurer, Distillers Corporation-Seagrams Limited. Mr. P.L. Underwood, Vice-President, Finance, W. & A. Gilbey (Canada) Limited, Mr. Harry Fraser, Executive Director of the Association.

Mr.Chairman, I would like to enter this brief into the record as Exhibit 241.

---EXHIBIT NO. 241: Submission of The Association of Canadian Distillers.

SUBMISSION OF

THE ASSOCIATION OF CANADIAN DISTILLERS

Appearances: Mr. G. Ross Herington — Mr. R.L. Underwood
Mr. Maurice Marchand — Mr. H.A.S. Fraser
Mr. H.C. Cox — Dr. J.R. Petrie

THE CHAIRMAN: Thank you Mr. Secretary. Good morning Mr. Herington, gentlemen. We are grateful indeed to you for having provided us with our weekend or week's reading. This is a very good coverage indeed of Canadian taxes and it has been extremely useful to us. Mr. Herington, let me start by introducing the Commission to you. Our names are all before us, and then I will ask you if you would be so kind as to introduce your associates -- you don't need to introduce your associates. We have all the names. The Secretary has done that.

We will have a number of questions to put to you but before doing so, is there anything that you would like to say by way of summary or amplification?

MR. HERINGTON: Mr. Chairman, I think perhaps we should emphasize that the submission is in two distinct parts. The first part deals with taxation of the distilling industry in particular and it reflects the views of all the members of our Association.

The second, longer part has been prepared by Dr. J.R. Petrie, who is the consulting economist to our Association. Our members are not qualified to assess Dr. Petrie's conclusions in detail, but we are in general agreement and, of course, Dr. Petrie is here to deal with any of the technical aspects that may require clarification.

If it would be helpful, I can make a very brief summary, paragraph by paragraph to introduce these various subjects?

THE CHAIRMAN: You mean by that all pages up to 12?

MR. HERINGTON: That is correct.

THE CHAIRMAN: By all means, do so.

MR. HERINGTON: Within that first part of the submission, we have suggested that distilling, although it is a normal manufacturing business in most respects, is subject to three major limitations:

First, there is the limitation of Canadian sales to ten provincial monopolies;

Second, there is the smothering effect of exorbitant discriminatory taxation; and

Third, there is the problem that our products for the most part take many years to reach the market, which means that there is an unusual element of risk and that very large amounts of working capital are required.

While we have been working against these limitations, the retail prices of our products have been grossly inflated by Federal and Provincial imposts to the point of diminishing return, with no increase in distillers' wholesale prices since 1956.

In this first part we outline some background information about the distilling industry.

In paragraph 4 we state:

Canadian distillers range from

comparatively small to very large organizations with major interests in the U.S. and other overseas markets. Except for two companies, they are Canadian owned and operated.

THE CHAIRMAN: Are there other distillers than the ones listed in paragraph one as being your members?

MR. HERINGTON: There are three more, very small ones.

In paragraph five we say:

The smallest as well as the largest distillers are heavily dependent upon the large U.S. market. Exports of 13,390,000 Imperial Gallons compare with 8,120,000 Imperial Gallons sold on the Canadian market. Further, the profits on exports are much better than on Canadian business because of the heavy weight of Canadian taxation.

We paragraph six we say:

Distriller, who have been faced with a cost-price squeeze like other manufacturers, have been unable to increase their prices in line with increased costs because taxation has carried retail prices to a point close to diminishing returns.

Distillers' wholesale prices have increased by an average of only 20 per cent since before World War II, compared with the 150 per cent increase in wholesale prices of other manufactured goods.

In paragraph seven we say:

The excise duty on Canadian spirits is at its all time high of $13.00 per proof gallon, having increased in steps since 1935 when it was $4.00 per proof gallon.

In paragraph eight we say:

Excise duties and taxes are levied on alcoholic contents but at different rates for spirits, beer and wine. Spirits are $22.75 per gallon compared with beer at $7.20 and wine at a $3.13 average.

In paragraph nine we say:

The effective rate of the 11 per cent federal sales tax is 32 per cent because it is applied on excise duty as well as in-bond value. Provincial sales taxes are then pyramided on the inflated Federal sales taxes. An example of the pyramiding of sales taxes is shown on page 5.

In paragraph ten we say:

The combined mark-ups on distillers' in-bond prices to retail prices range from about 442 per cent to 635 per cent. No other product is subjected to this weight of taxation.

In paragraph eleven we say:

In 1935 the distillers received 35 cents of the consumer dollar but by 1938 this was reduced to 29 cents, by 1963 to 16 cents.

As shown in the schedule on page 6, comparing distribution of the consumer dollar in 1938 and 1963, the Federal Government now takes 36 cents and provincial governments 45 cents compared to the distillers' 16 cents.

In paragraph twelve we say:

The federal share is for the most part net to the Government; the Provincial share provides only warehousing and minimum cash-and-carry distribution: whereas

the distillers' 16 cents must cover production and marketing costs, and provide earnings for improvements and for dividends on the investment of some 60,000 Canadian shareholders.

In paragraph thirteen we say:

The industry is a major revenue source for both Federal and Provincial treasuries. In 1962 the Federal revenue from excise duty on Canadian spirits was $113.7 million and net Provincial liquor revenues were $248.3 million. The latter is illustrated in the schedule on provincial revenues (page 8).

In paragraph fourteen we say:

On page 9 the relative importance of liquor revenue with individual provinces is shown. In 1962 it averaged 10.9 per cent of all revenues.

In paragraph fifteen we say:

Despite the gross inflation of retail prices by discriminatory taxation, total sales of Canadian spirits in the Canadian market have continued to increase but there has been a marked tendency for consumers to downgrade their whisky purchases from the higher to the lower priced brands as shown on page 10.

In paragraph sixteen we say:

Canadian whisky accounts for about 60% of the total sales of all Canadian spirits in Canada and the relative decline of the more profitable higher priced brands, coupled with the cost-price squeeze, have reduced distillery profits from Canadian business to a return that is lower than on a high grade government bond.

In paragraph seventeen we say:

The lower profits resulting from high taxes obviously represent a loss from the corporation income tax potential but they also limit the production and employment potential of the industry.

In paragraph eighteen we say:

About 70 per cent of adult Canadians admit to using beverage alcohol and the onerous taxes amount to a heavy discrimination against them as compared with consumers of a wide range of other luxury products.

In paragraph nineteen we say:

There is also discrimination at the municipal level in Ontario that dates back to 1904 when other taxation was not a factor. Under the Ontario Assessment Act distillers are assessed at 150 per cent of the value of their properties compared with 60 per cent for nearly all other manufacturers.

Our recommendations, very briefly, Mr. Chairman are two:

1. Reduce the excise duty on spirits so that it will be more in line with other commodity taxation, particularly wine and beer.

2. Eliminate the anomaly of the sales tax being computed on the duty-paid value of spirits rather than on the in-bond value.

THE CHAIRMAN: Just wait until I get the second one: Eliminate the anomaly of the excise tax being computed on duty-paid value?

MR. HERINGTON: That is correct. Sales tax on the duty-paid value.

THE CHAIRMAN: Thank you Mr. Herington. I

don't see how one can argue that this product is not subject to discriminatory taxes and, of course, it is not alone in that. Other products are discriminated against by taxation. Historically, what is the reason for the high tax on liquor?

(Page 4738 follows)

Is it based on any social measure to lift liquor, by means of increasing its price, beyond the reach of those who are thought not to be able to consume it with good judgment?

Is there a social measure here or simply a revenue measure?

MR. HERINGTON: I should think there have been -- I would say certainly there has been a social measure going back to prohibition and there has been a feeling, and I would think that there has been that feeling perhaps more in the past than now, that beer and wines would be better and less likely to abuse. I would think that in the past -- there always are some abuses -- but in the very distant past, I suppose there was more ground for that in that the distribution was not as well-organized as it is now in bars and licensed premises, and possibly must have been very conspicuous, as I am sure it was, and it may be at least easier to impose high taxes for the sake of the revenue.

THE CHAIRMAN: I really look on the tax as being, I think, about $3.50 out of $4.25 whisky, something of that nature. Supposing one reduced the tax to where it was not discriminatory, and reduced the $4.25 whisky to $1.00 or thereabouts, do you think that would have any unfortunate social consequences or would you be prepared to say it would not?

MR. HERINGTON: I think it is a very interesting idea. I think, as with many things that change as suddenly as that, you would have some immediate unfortunate effects. In the longer term, it may be harder to say.

I think initially you would have people accustomed to drinking beer and wine who would immediately change over and perhaps not handle the spirits as they should.

I doubt very much if, in the long term, it would mean any great abuse. There are a great many comparisons to be made, such as anyone serving in the Royal Navy can have this gin for tuppence and it doesn't mean that drunkenness results, in my observation.

THE CHAIRMAN: Then you are not asking, really, that we should immediately eliminate discrimination. You are saying that it is too great?

MR. HERINGTON: That is it exactly.

COMMISSIONER WALLS: Following up the same line of thought, is it not a fact that while our Canadian excise duty is $13 per proof gallon, that the United States excise tax is, on the basis of a Canadian gallon, $14.40 a proof gallon, and that Britain is $29.50 per proof gallon.

Would that not tend to show that this has been recognized as a revenue producer, or for social purposes in all countries in the world?

MR. HERINGTON: I think certainly the answer is yes. I am not familiar with one or two of those percentages you quote. I should think in all countries it is a matter of degree. There is certainly this: it is a revenue producer. Whether the social aspects are all the same, I don't know.

COMMISSIONER WALLS: It would appear, you see, that taking the United States and United Kingdom, which are the two countries that you might say would

compete in the majority of the products that you produce, that their taxes are higher than ours at the present time.

Now our per capita consumption, I believe, is relatively high in comparison with those countries and as our excise duty is very much in line, if not lower than other countries, and we have to get the revenue, yet as we do not get very many complaints from the consumers themselves, is it not evident. They also realize that this is about as easy a way to raise revenue for the Government as any other means.

MR. HERINGTON: I think we may be a little closer to these consumers. They do complain and complain bitterly and react strongly every time there is a price increase imposed by Provincial monopoly and their reaction has been shown by the downgrading to lower priced products, presumably to some extent within the spirits market; only beer and wine.

They certainly are not inclined to organize as a body, but it does not really mean that they are not complaining.

COMMISSIONER WALLS: Could this feature of the complaining, and I would presume that it would be to the Provincial Liquor Commission rather than to the distilleries and, if so, does the fault not greatly lie with the percentage of profit that is taken by the monopoly in each province?

MR. HERINGTON: I think that is a substantial part, and of course, it varies between provinces. Some take a much higher mark-up and, to some extent, there is a form of protest there because those high-priced

products -- provinces do receive a certain amount of spirits any time that a resident travels to another province and there have been some good examples of that.

COMMISSIONER WALLS: Is it not a fact that some provinces also charge a higher margin of profit on imported whiskies than they do for the domestic whiskies?

MR. HERINGTON: I think that point has been debated. They perhaps normally would have a slightly higher mark-up as a percentage, but then on imported products the provinces will have more warehousing and more costs of various sorts, so that I think if you, in general, took in all the costs that should be there, and their laid-down cost, and costs for warehousing, in many cases they may only order twice a year, where Ontario they order weekly from Canadian distilleries, the proportion of the mark-ups is about the same.

COMMISSIONER WALLS: Because you brought up this subject in reply to my first question, it may be I am jumping a little head in your submission but you mention that there is a swing by the consumer, in protest, to lower-priced brands. Could that not be as a result of your lower-priced brands improving in quality and also the highly decorative type of bottles you induce people to buy now?

MR. HERINGTON: I think it may well be true that the lower-priced whiskies are better than they were in the distant past, but I don't think the pattern of change is quite that obvious. You do have curious results on pricing. If in one province a particular line

or classification of whisky happens to be exactly $5, the people seem to be attracted to that. I suggest that they are looking at the dollar sign. They must, presumably, be satisfied with the Canadian whisky at the lower priced category.

THE CHAIRMAN: If you do not make as much profit on the low-priced brands, as you do on the high-priced brands, why don't you shift your profits from one to the other?

B/RPS

THE CHAIRMAN: So that the shift doesn't reduce the profits.

MR. HERINGTON: I think in general distillers do advertise and promote their higher-priced whiskies. I cannot speak in detail for all distillers, but in our case we normally advertise the higher price range assuming that the corporate name will do the same for the lower-priced ones. If we have any form of campaigns it would almost invariably be the higher price.

THE CHAIRMAN: Does that mean your cost on the higher price line can be as great as it is in the lower price line?

MR. HERINGTON: That is right.

THE CHAIRMAN: That is to help with the advertising?

MR. HERINGTON: No, I think the advertising comes along afterwards. There is more margin of profit and from that point of view you can justify a little more advertising.

THE CHAIRMAN: If I may pursue this just one second. You are complaining the profits were declining because of the shift from one to the other as a result of the high tax.

MR. HERINGTON: Yes.

THE CHAIRMAN: It is reducing your profits and your profits are reduced because you are selling cheap products more than expensive products. I don't see why you don't reduce your profits on the high-priced stuff and increase profits on the lower price and it would come out the same if you did that.

MR. HERINGTON: That would be to suggest the distillers should change their pricing to the provinces and increase the prices at the lower end.

THE CHAIRMAN: I don't know anything about your pricing, but I guess that is what I am suggesting.

MR. HERINGTON: As you know one thing we as an organization cannot do is discuss pricing. I think that would be an answer. I would be glad to see it implemented.

THE CHAIRMAN: I am not sure that this is the full answer because I would think if it were that would have been done without conferring. You would have done it naturally. The leading members of the industry would have proceeded to do that in order to correct an unfortunate situation and others would follow because it is in their interests to maintain profits. Thank you.

COMMISSIONER WALLS: Do you think that if the Federal Government reduced the excise tax that the Provincial Government would not just take up the slack and increase the consumer price?

MR. HERINGTON: I believe that I understand that could be provided for in any much adjustment but even apart from that I think that most provinces, this is hard to prove for sure, but I think many of them at least would reduce their prices because they are conscious of the price being high. They stick to their bond trading because there are less dollars and cents coming in on the sales of lower-priced whiskies than higher-priced whiskies. Ontario, I think takes some pride

in having the lowest prices. I think there is a general feeling, not only in the industry, but among the Commission personnel that prices have gone a little higher than they should have.

COMMISSIONER WALLS: I sympathize with you, personally.

DR. PETRIE: It might interest you to know, Mr. Walls, the last time there was a decrease in the excise duty, I think was in the 1935 budget when it was decreased from $7 to $4 a proof gallon, and the then Minister of Finance announced in the budget speech that any province that failed to pass on the whole of the saving would be subject immediately to the last proceeding rate of duty. In other words he was using it as a lever to force them to pass it on to the consumer. This has never been done since because we have never had an increase in the duty since then. It has always gone up.

MR. HERINGTON: May I read you one paragraph from the Excise Act:

"In the event of any duty imposed "under this Act upon spirits, malt or beer "having been reduced, if it is made to appear "to the Governor in Council that in any "province the prices of spirituous or malt "liquors to the consumer have not been "reduced to, are not being maintained at, "levels that will give the consumer the full "benefit of any such reduction, the Governor "in Council may order that such reduction shall

"be no longer in effect and, upon publication "of such order in the Canada Gazette, the "full rates of duty theretofore payable "on such goods shall again be in force and "effect."

COMMISSIONER WALLS: Where you are talking about pyramiding of the sales tax on top of the excise duty plus your manufacturing costs we have had a number of representations, as you may have noted from various participants, that the sales tax should be moved forward to one level, and by some to another, but if we moved it forward to the retail level as many people have suggested you still, ~~in liquor,~~ would run up against the same pyramiding as you do today, don't you?

MR. HERINGTON: We would then be on the same basis as others.

COMMISSIONER WALLS: There is another solution, perhaps, and I would like to ask you a number of small questions in regard to your industry and how you operate under the excise duty because it will then leave another alternative that I might put before you. First of all as I understand it you, by law, have to store for a minimum of two years. I know you store for longer. As I also understand it, excise duty is computed on the highest returns from a possible five different tests. Am I right in that?

MR. HERINGTON: I haven't any knowledge of five different tests.

COMMISSIONER WALLS: What I have read as being the tests is that one test that is taken is the amount

of grain used, and you have an alcohol grain ratio, which is sometimes used. There are two tests going through the manufacture for alocholic content. Then you have something called a spirit receiver which is the fourth one, and finally the quantity of spirits drawn out of storage for consumption. I would imagine that the last one is the most logical one as a means of basing your excise. Is my other information incorrect?

MR. HERINGTON: I would look at it in a rather different way. The excise control force starts with the grain, and they know what the yield should be. If you run over the maximum allowed between one step and the next then you are penalized for that, for the excise duty payments, if we pay them. We may ship in bond or we pay duty first based on the last test.

COMMISSIONER WALLS: So, then, you customarily only pay excise duty and the sales tax when the liquor is sold out of bonded warehouses?

MR. HERINGTON: That is right.

COMMISSIONER WALLS: And you pay them at the same time?

MR. HERINGTON: Yes, we must pay them; if we ship in bond it goes to the bond warehouse.

COMMISSIONER WALLS: That is right. When do you place the sticker over the cork of the bottle?

MR. HERINGTON: When?

COMMISSIONER WALLS: Yes, in what stage of the process?

MR. HERINGTON: That would be the final, the bottling operation before the bottles are put in cases.

COMMISSIONER WALLS: Why does the sticker show the age on Canadian liquor when the imported liquor doesn't require that?

MR. HERINGTON: I look upon that not as much as a requirement, as a privilege, as a seal of authority that the whisky was distilled in the year shown.

COMMISSIONER WALLS: Therefore out of excise duty you are getting a certain amount of advertising benefit by the use of that tag, are you?

MR. HERINGTON: I consider it of definite value. I think all members would.

COMMISSIONER WALLS: On the domestic market you only sell to Provincial Government warehouses who also tag the corks. Do you think your tagging could be eliminated? What I am getting at, you are restricted to another Government, who in effect holds that liquor in bond. Why is it necessary for the double operation of tagging?

MR. HERINGTON: Strip stamps, the Provincial strip stamps have been eliminated in all provinces except British Columbia, and Ontario is going out just about now. That has been a source of worry to us for many years because you would have to have all of the run bottled separately for each province. Using a Federal strip stamp on the whisky we could bottle together, which represents a substantial economy in bottling runs.

COMMISSIONER WALLS: I must apologize for that last question. Coming from British Columbia and recently spending all my time in Ontario you can see how I was misled on the Provincial tag. Is there any reason why

the excise duty could not be collected further forward if we moved the sales tax further forward? In other words could you pass your liquor on in bond to the Provincial Liquor Commission and then have both the excise duty and the sales tax, collected at the same time, if we decided to move sales tax forward?

MR. HERINGTON: We have advocated something along these lines because in cases where provinces order shipments to go out to bonded warehouses the duty payment is required, and particularly in the seasonal period before Christmas we have literally millions of dollars outstanding which provinces are to repay to us. Very often they are going to take two or three weeks, probably. The sales tax is collected on a monthly basis and we have suggested that there would be a saving all around if the excise could be dealt with the same way which seems fair enough when the Federal Treasury is dealing with Provincial Treasuries and with established businesses. It would seem to be a gain for all concerned.

COMMISSIONER WALLS: So that would be one way of getting around the pyramiding, if the sales tax was moved forward to the retail level and at the same time the excise tax was collected. It would be quite possible this would remove any pyramiding of sales tax on top of excise tax.

MR. HERINGTON: Yes, I think that would be probably true.

THE CHAIRMAN: The only question I wanted to ask on administration, it appears to some of us, without knowing very much about it, that the method of

collecting excise duties is rather archaic. It is not very clear and is probably expensive. Would you not say that there must be an easier and simpler and cheaper method of doing that, and is that the question Mr. Walls put to you on which you said you had made a proposal to the Federal Government?

MR. HERINGTON: We are probably in favour of that. It wouldn't change the load of taxes. We have something like $3,000,000 floating around at all times in the financing of excise duty.

THE CHAIRMAN: How about collection cost which is the matter I am thinking about, is there a cheaper and more efficient way of collecting these duties and taxes?

MR. HERINGTON: There would be some saving in avoiding numerous transactions during the month, in that there would be recording and one transfer of funds made by the distiller.

THE CHAIRMAN: I would assume there would be some reaction in the degree of security, but that is probably answered with the well-established companies?

MR. HERINGTON: I would think there would be no significant loss of security. These transactions are controlled so well at each point of movement or change.

COMMISSIONER WALLS: Still payable on the same basis the same as you are paying today?

MR. HERINGTON: Yes.

THE CHAIRMAN: Mr. Grant has I think some points on this.

COMMISSIONER GRANT: What page are you on?

THE CHAIRMAN: Have you anything on his questions?

COMMISSIONER WALLS: I was going to move forward then to page six. I notice on page 6, paragraph 10 you are talking about Federal tax and Provincial taxes and revenues. By Provincial taxes you are just referring to the two Provinces that have a small liquor tax, Quebec and P.E.I. Are you referring only to sales tax that these provinces put on?

MR. FRASER: Sales tax and the mark up.

COMMISSIONER WALLS: Of course mark up is not a tax.

MR. FRASER: It is a revenue.

COMMISSIONER WALLS: It is a revenue, and I just wanted to make sure when we talk about mark up that the provinces puts on we are not dealing with taxes, we are dealing with marketing margin, are we not?

MR. HERINGTON: I think it is difficult -- there is a difference between tax and mark up, but the mark up in this case is very close to a tax in that we are not selling to a company that is trying to get its return from the market. This is an assessment for which they pay warehousing and cash and carry operation but they don't have many of the aspects of business organizations, so that the mark-ups that they put on are not required in a business sense at all.

THE CHAIRMAN: There are two factors there, really: There is the normal market transaction which extends up to a fair profit having regard to the risk.

What the province gets over and above that is akin to a tax, I would assume.

COMMISSIONER WALLS: On the bottom of the same page where you are dealing with what happened since 1938 and the fact that the Federal Government has increased its revenue by 34 per cent, provinces by nine per cent whereas the distiller has gone down 44.8 per cent. You would credit that as a result of tax rather than the intense competition in your own business?

MR. HERINGTON: No. The advertising and sales promotion expense is not that much of a factor. The reason for the change is that the Federal Government has increased the excise and the provinces have marked up their prices in the last few years where ours have remained steady. It is not as if it was a free market and we were selling direct to the public where we might in competition reduce prices to gain more business. It isn't that at all because we haven't reduced or increased since 1956.

COMMISSIONER WALLS: By the same token, as there are only a limited number of people in your business is there anything to stop you when your costs go up from increasing the selling price the same as in most products who have competitors?

MR. HERINGTON: But for the provincial monopoly that exists. When one of our members attempted to increase its price not too long ago the answer from several provinces simultaneously was go ahead, we don't need your products. There are a number of distillers that will provide the products which our customers will accept. That

may or may not be a good example but the Provincial monopolies can take that attitude. They are under no pressure, presumably from their treasurers to produce revenue and wouldn't be happy about having to put up retail prices to accommodate increases whether it be through reducing their prices or in any sense let us have any more out of it. It is not easy for any one distiller to do that and it is impossible for distillers to get together to do it at the same time.

THE CHAIRMAN: You collectively are in just as strong a position as the provinces, surely. If they refused to buy your liquor that is no stronger action that you refusing to sell them liquor. It is true if they pick on one of you that may by itself hold prices down, but it would seem to be your bargaining position is only weaker than theirs because there are a number of you and it is a matter of time if you all force your prices up if you need to.

MR. HERINGTON: I think we need to. I think the position you state would be correct if we could discuss a move together, or some parts of us altogether. There are certain brands that could scarcely be removed from the market without objections being fairly strong, such as Canadian Club or Seagram's V.O. I think it would be a serious matter for a province to refuse to market them.

THE CHAIRMAN: I would think so. It would seem to me that the distillers would be in a pretty strong bargaining position with those products.

MR. HERINGTON: Those two might be. I

don't feel in our company we would be strong. They will say we will buy other brands or cut down our order.

COMMISSIONER WALLS: Just one point more: it seems to me, Mr. Herington, you are, perhaps, riding two horses on this request for reduction in excise duty. One part of your brief states that you are getting consumer resistance as a result of the tax.

/rps

Yet in paragraph 17 you say:

"The lower profits resulting from high "taxes represent a loss from the corporation "income tax potential."

That is, you are in effect saying that if you get a reduction in excise tax, you will retain it in order to increase your corporate earnings. Now aren't these different purposes for which you want the excise tax reduced?

MR. HERINGTON: If the excise tax is reduced, that would not save us any part of that reduction, as such, because we do not pay it. It would result, or should result in the lowering of the retail price which would have the effect, we believe, of correcting this downgrading and we would then be able to sell more of the high-priced and more profitable lines.

Of course, it is only stating the obvious: if our profits are reduced, the Federal profits tax is reduced. I think the way you put it would suggest that by cutting the excise duty, that would be money in our pockets. It might well be, and hope it would, but not immediately and it doesn't mean we would get any excise duty reduction.

COMMISSIONER WALLS: Thank you.

THE CHAIRMAN: I have a few questions. Have you any questions?

COMMISSIONER GRANT: Yes. If you eliminate from your consideration the raising of the prices to the monopolies, your sole hope for relief, for a better position, from the point of earnings, is that a reduction in the excise duty will be passed on to the consumer,

which will result in stimulating sales?

MR. HERINGTON: That is correct.

THE CHAIRMAN: Wait a minute. No, that is not what he said. It was not stimulating sales. It was changing the nature of the sales from the low priced to the high priced product. Not increasing sales.

COMMISSIONER GRANT: I am very conscious of the fact that that is what Mr. Herington said but I still would think that it would have the effect of stimulating sales, and it would otherwise, unless it is stimulating sales of the better priced whiskies on which there is more margin of profit.

MR. HERINGTON: I don't think we can conclude that sales overall would be stimulated. The monies spent on spirits as in proportion to net disposable income -- I think we have some figures on that -- it might be that there would be some stimulation of spirits, as compared to beer and wine. The alcohol that is consumed in beer is sustantially greater than the alcohol consumed by way of spirits. 61 per cent of the total, talking absolute alcohol, is sold in the form of beer. Wine, seven per cent and spirits is only 31 per cent. Now if there is a stimulation, apart from changes of buying habits, it might well be that beer and wine would suffer a little from this, to our benefit and to the benefit of the provincial revenue as well.

THE CHAIRMAN: It could make you more competitive with those others?

MR. HERINGTON: Yes.

THE CHAIRMAN: On page 11, paragraph 16 the

statement is made that the distillery profits from Canadian business have been reduced to what could be regarded as a lower return than that which could be obtained on a high grade Government bond. In making that statement are you computing the return on capital employed in the business?

MR. HERINGTON: Yes.

THE CHAIRMAN: So that you are not pinpointing what is a return on the Government bond. Let us say that it is four and a half per cent on a high grade Government bond. Then the return on the capital employed to the distillery industry is in the vicinity of four and a half per cent.

MR. HERINGTON: I am not personally in a position to confirm that exactly because the two largest distillers, Seagram's and Walkers published statements that are world-wide, consolidated. I understand that they have made analyses of the capital employed for the Canadian business.

I don't know whether Mr. Cox would comment on that or not, but it's the Ontario shareholder of the smaller distilleries who again, two in particular, have stated publicly that without the export business they might be in a very bad way, but they do not normally divide up their financial returns either to show exactly what is in the Canadian business.

Doctor Petrie, as a tax economist is satisfied that this statement is substantially correct and that is about all I can say on the subject.

MR. COX: May I add something to that? We are

a national organization. A great part of our sales, in fact over 90 per cent of our sales, are outside of Canada. For the production in Canada, about 60 per cent of it is exported. In order to breakdown our capital employed we have to do it pretty well on a case basis pro-rated. Using that as a criterion, we find that return on capital, without taking any interest on the net borrowings, or anything like that, but on the straight capital employed, in order to provide the goods, work, warehousing, machinery, is less than five per cent.

COMMISSIONER GRANT: Would you be in a position to relate that to sales? That is, what are your net earnings of the industry in relation to net sales? Have you any figures on that?

MR. HERINGTON: I don't have that.

THE CHAIRMAN: If you limit your sales to your capital employed, of course we can work it out. If sales would be 2-1/2, capital employed is five.

MR. HERINGTON: I have difficulty in doing that in any exact way because of the problems on what is a sale? There are so many taxes all the way down the line; certainly Seagrams and Walkers publish sales figures in total. We don't in our company but just what is in their sales, I don't know.

COMMISSIONER GRANT: What I am trying to get at is that the Association is looking for some relief from taxes. I suppose it is incumbent upon us to find out whether the Association is in need of relief. Is it suffering? The fact that taxes are discriminatory is

admitted, but as to whether or not the industry is in need of assistance, it would be relevant, I should think, to know just how your net earnings -- what your net earnings are as an industry in relation to sales, in comparison with other industries. Take, for instance, the grocery business. It is generally conceded that the net earnings in the supermarket type of operation is less than two per cent in relation to sales. Other industries feel that it has to be about four and a half per cent in relation to sales.

That is why my questions are directed to you, to see if we could spell out a need in that way.

MR. HERINGTON: Well we don't have the figures consolidated by distilleries to answer your question and it might not be meaningful if we did, because of the businesses such as Seagrams and Walkers, with their export business, some possibly more in the middle where exports are not of great importance; some of the smaller companies such as Melchers and McGuinness have indicated -- Mr. Marchand might wish to say something on this, they would have very little indeed if they did not have some export. I don't know whether Mr. McGuinness' remarks just made at another meeting -- if we may deal with that. Is that in order?

MR. FRASER: I think that is in order Mr. Herington. At a meeting we had in Ontario in June, we were discussing the Assessment Act of Ontario. Mr. McGuinness told the meeting, at which the Prime Minister of Ontario was, that he had his auditors check through their financial statements 1951 and 1961. In 1961 his

profits were only $4,000 higher than in 1951 but he had eight times the volume of business.

COMMISSIONER GRANT: That shows a great increase of efficiency doesn't it and the consumer is getting as good a break as he can under those circumstances?

THE CHAIRMAN: If Mr. Grant has no further questions on this profit thing, I would like to pursue that. I am very surprised at this figure of five per cent return on capital. Of course it depends on what capital employed means, but if one was talking about the price earnings ratio in the market, I suppose it is about 20 to 1, would it be, or five per cent? I don't know. But when one talks about the ratio of earnings to capital as shown on companies' books, usually it's a great deal more than that. The national average for all manufacturers, Dr. Petrie will know better than I do about this, I think is eight or nine per cent as compiled by the Canadian Manufacturers' Association.

I don't know why the distilleries should be so much lower than the national average. The national average for all sales ratio is something like five point something, five point six, something like that. And then of course it comes out a great deal higher for a return on capital. I am interested in return on capital because one invests to make a return and if my return on capital is down roughly to what the price earnings ratio in the stock market is, that would be very extraordinary to find that that is the case because certainly across the board in this country it's nothing like that. The stock market values are generally

a great deal higher than the balance sheet value but if what you say is true, stock market value would be roughly the same as balance sheet value or your shares would be traded at the net worth of the assets. That would rather surprise me. Would it surprise you Dr. Petrie?

DR. PETRIE: No, I don't think so Mr. Chairman. When we talk about this problem as to why the return on investment in the distillery industry should be lower than the average in the manufacturing industry, it must always be borne in mind that the average wholesale price of manufactured goods has gone up one hundred and fifty per cent. Ours has gone up around 20 so that as the cost of manufacturing has gone up, for manufacturers in general, they are recovering those costs through increased prices, well since 1956.

My clients have not recovered any of the extra cost and they have not increased prices. Therefore, you would expect to have a much lower-than-average return on your investment however you define capital investment.

THE CHAIRMAN: So you think that if one took the stock market values of this industry and compared them with the balance sheet of one of these other industries, it would not be far apart?

DR. PETRIE: I would suspect they would not be.

COMMISSIONER WALLS: Is it not a fact, however, that you are not paying any more for your grain today than you paid previously?

DR. PETRIE: I think somebody from the industry should speak to that. My impression is grain has gone up like everything else.

MR. COX: Grain and glass and labour.

COMMISSIONER WALLS: I agree with that.

DR. PETRIE: What about grain?

MR. COX: I would say grain in the last two or three years has definitely gone up.

THE CHAIRMAN: You would know about that Mr. Walls.

COMMISSIONER WALLS: That is why I asked the question.

COMMISSIONER GRANT: Is automation a factor in the distillery industry? Are you able to do a lot more now with machines than was possible 20 years ago?

MR. COX: Yes, to the extent unions will let you automate. To put automation in your plant, you have to work it very carefully with the permission of the unions.

COMMISSIONER GRANT: Are you under any disability in that respect?

MR. COX: Yes.

COMMISSIONER GRANT: You don't mean to tell me that management are submitting to the dictates of a union in that respect do you?

MR. COX: Yes. We were under the control of one of the strongest unions in North America contained in the Distillery Workers of America and while we can make certain steps towards that, you have to go along pretty well with the unions or you have a strike on

your hands or you have very difficult labour negotiation the next time round and you have got to renegotiate a contract about every two or three years.

COMMISSIONER GRANT: I shouldn't think your industry would be very much different, say, from the dairy industry in that respect and I have never heard that the dairy industry were prevented from installing machinery for more efficient operation of their industry because of a union.

MR. COX: That is not what we have found.

THE CHAIRMAN: I have got two questions. You refer to the employment potential of your industry and you point out it might be greatly improved by automation which might result in increased volume. I don't quite see how that comes about but what is the measure of the employment potential? If you do 20 per cent more business, you would not increase your employment by 20 per cent. You would increase your employment by something a great deal less than that. What kind of increase in employment may result from an increase in total volume?

MR. HERINGTON: That perhaps might have a little different answer in our case. I would be very interested in extension of our operations to related spheres. The idea of broadening our base in relating capital on the one set of products -- I don't mean we want to invest, in general, something completely unrelated. There are some companies of that sort which we have been investigating which would require funds. In some of these investigations there may be opportunities

that are just a little beyond us.

THE CHAIRMAN: Developing other lines?

MR. HERINGTON: Yes.

THE CHAIRMAN: I see. That is really what you have in mind yourself?

MR. HERINGTON: Yes.

THE CHAIRMAN: When you spoke about employment potential. Is that what the other members had in mind too? Are you speaking for the industry or yourself when you are saying that?

MR. COX: Certainly Seagrams are diversifying in many different things because we have diversified especially in the bi-product field into the feed for cattle on quite a large scale near Waterloo Ontario so that now we are probably becoming second or third largest cattle feeder in Canada.

THE CHAIRMAN: Next in employment potential you say employment potential of the industry. You are really thinking about employment potential perhaps in that industry, but outside the industry too. Had you another question? I think, first, I am told that it is very difficult to see the operation of the law of diminishing returns. Has anybody ever noticed that higher prices cause volume to drop?

MR. HERINGTON: Yes, I think this is perhaps a question for Dr. Petrie. In one particular province the prices were put up twice in a fairly short period, I believe against the advice of the Commission itself but other conditions did not remain static, so it was hard to prove what would have happened if they had not done that.

RPS

I think though that any reasonable analysis, including in this case the Commissioners is very close to the spot that the excess of revenue would have been higher. The high price provinces -- I don't know whether I care to mention it, I think the results were quite clear despite the fact revenues in total were up slightly they have many other forces and unusual tax conditions. Is it not clear as a mathematical answer might be. Dr. Petrie, could you answer that?

DR. PETRIE: It is really difficult, Mr. Chairman, to make a case definitively. We think in terms of physical volume of sales, not dollar volume. We have ups and we have downs. You think you have something concrete then you remember there was a beer strike in Ontario for a period of weeks and if people wanted to use alcohol they had to use spirits and spirits went up. The last increase from $12 to $13 proof gallon -- there was an interim falling off but it didn't last. The record will show in 1962 the volume again talking in terms of physical volume increased. Whether it would have increased more, I don't know and I don't think anybody knows. I think the only definitive example that could be produced is as a result in 1935, 1936, when the excise duty was reduced from $7 to $4 by the Honourable Mr. Rhodes, then Minister of Finance, although there weren't the adequate statistics of sales and consumption we have now they show in D.B.S. statistics, control and sale of alcoholic beverages for 1936, you see in Ontario and Quebec a very marked jump in the legal and tax paid consumption of spirits because that

saving was actually passed on, as I said earlier, because the Minister required it to be passed on by the provinces to the consumer. There was a marked increase in sales. We have looked at the rate of increase in the Federal Excise Tax yield which until the recent increase in duty had been going up at a pretty substantial level running ahead of the rate of increase, annual average rate of increase of net disposal personal income to Gross National Product. The rate of increase while it is still positive is still only about half . . .

MR. HERINGTON: 15.4.

DR. PETRIE: It was 15.4 per annum and it is down now to four something.

MR. HERINGTON: The schedule showing excise duty revenues on Canadian spirits from 1954 to 1962, the average annual rate of growth for the six-year period, 1954 to 1959, excise duty $12 a proof gallon, 15.4 excise duty. On $13 proof gallon coming in 1960 the rate of growth for the following three years dropped to 5.6 per cent, so it is up. It means there was this distorted trend in the revenues of sales tax.

THE CHAIRMAN: Of course there may have been other reasons for this drop than the increase in the excise. What was the year like economically, a good year?

DR. PETRIE: A turning point year.

THE CHAIRMAN: That is right.

MR. FRASER: In 1960, Mr. Chairman, the relationship of the amount of money spent on spirits in relation to disposal income was still one point six.

it is 1.6 since 1957 right through to 1962. Don't forget, sir, that 1956 and 1957 our member companies were selling a higher amount of high-priced spirits than they are today. It is still the same amount of cash money that went in the cash registers but it is the sales of lower priced spirits.

THE CHAIRMAN: You don't make as much profit.

MR. FRASER: Nobody made as much profit, any of the companies or the Liquor Commission. Another thing, Mr. Chairman, in fiscal, 1960 which is March 31st after excise tax increase from $12 to $13 a proof gallon sales of spirits in Canada dropped, showed a sharp decline below what it had in fiscal 1959.

DR. PETRIE: This was temporary. I think, Mr. Chairman, it was probably one of the psychological factors. Suddenly the prices of spirits across the board went up because of the increase in duty and probably, I say probably many people said it is too much. We experienced this in cigarette taxation during the war when people started to roll their own, although they didn't keep rolling their own too long, they went back to their own pattern and adjusted to the increase. They still spend as much of their disposable personal income as they did in the past on spirits, on a lower grade spirit, lower priced spirit.

The same dollars and cents come through the turnstile, the cash register of the liquor stores.

THE CHAIRMAN: I have a hard time understanding why you can't increase your prices on the low cost product if you need to increase your prices.

DR. PETRIE: May I speak to that from an

economic viewpoint: when a desirable increase in price by X dollars cost us X cents a bottle the multitudinous effect at the retail level is very many times the distillers' increase in price. There are two highly competitive beverages competing with spirits, one is wine and one is beer. If you increase the price of your lower grade or lower cost whiskies up, let us say 50 to 75 cents a bottle, I am surmising -- I am guessing as one must always do because it is an imponderable -- I am guessing there would be a marked shift from the cheaper alcohol and it is very much cheaper when you consider by volume wine and beer and spirits.

If we upgraded the price of the lower whiskies then we would lose business to the wine and beer industry. That is my guess.

THE CHAIRMAN: That is because the method used to impose tax, if the tax instead of ad valorem were weighted more towards the specific you wouldn't have that effect.

DR. PETRIE: Not as much because Federal excise duty is $13 regardless of the value of the spirit.

THE CHAIRMAN: That is right, it is.

MR. HERINGTON: There is another factor here that is very hard to assess, how much would be lost to a illicit alcohol. Mr. Fraser has a statement that I think might well be read. It is not something covered in our brief, but the information we have comes from official sources and certainly indicates an element of danger of loss of revenue through distribution of illicit

alcohol and that danger becomes greater the higher price of the legitimate alcohol.

THE CHAIRMAN: Do you mean bootlegged?

MR. HERINGTON: Moonshine.

THE CHAIRMAN: Moonshine within the country?

MR. FRASER: Could I read this out:

"The 'moonshine' or illicit alcohol "problem in Canada is becoming a well organized "racket to the detriment of the Federal "Revenue, as well as to the industry and to "the Provincial authorities. There is "evidence from official Government sources "that illicit distilling operations are "increasing rapidly. The number of stills "seized annually has doubled in the "past five years. A comparison of "seizures, over the past two years, is given "below:

	Fiscal Years 1961-62	Fiscal Years 1962-63	% Increase
"Seizures involv- "ing spirits, wash "and stills	599	840	40.2
"Seizures involv- "ing spirits	479	663	38.4
"Seizures involv- "ing stills	254	289	13.8

"(The total capacity of the 289 "stills seized is estimated at 4,500 gallons

"per day.)

"Many of these stills produce alcohol "at or near 165° of proof. Based on "this strength and the current excise duty "rate of $13.00 per proof gallon, the loss "to the Federal Revenue on an annual basis "approximates $35 million."

COMMISSIONER GRANT: That is assuming that these supplanted the legitimate product.

MR. FRASER: If you put it on a daily basis the Federal revenue has lost approximately $96,000 a day for each day those stills were permitted to operate. There is a ready market for them.

THE CHAIRMAN: There is a fallacy because there is a ready made market at the bootleg level or moonshine price which wouldn't be the same market if those liquors were sold at liquor store prices.

MR. FRASER: Mr. Chairman, don't forget there are some people that can't afford to buy legal spirits. They don't like the taste of beer or wine so they are going to illicit alcohol. There is one section just outside of Montreal -- this was taken from MacLean's
2 Magazine, August 24th. This magazine states there are some twenty-five illicit stills between Montreal and Quebec only which turn out 50 to 200 gallons a day. Sales at the ultimate consumer level are estimated at $25 million a year. All that is money which is going into the bootlegger's hands and not money to the coffers of our companies and the Federal Government due to the high price.

COMMISSIONER GRANT: Mr. Fraser, you would admit there is a lot of illicit alcohol that gets into the hands of people who would never enter a liquor store ordinarily?

MR. FRASER: Mr. Grant, I have information given to me from a highly confidential source that there are about a thousand gallons of illicit alcohol going to a major city in Canada today finding its way into private homes and into bars.

MR. HERINGTON: I think it would be correct to say what gets into the private homes is business that wouldn't be obtained by legitimate distillers but how much turns up in bottles that are put out in bars and clubs is different. There may not be that reduction at the ultimate consumer level.

COMMISSIONER GRANT: That is about 25 per cent of the estimated output that does find its way into sources which can supplant the legitimate product.

THE CHAIRMAN: This information is a surprise. I hope this information is passed on to the R.C.M.P. and proper authorities to check on this information. It would seem to me very much in your interest.

MR. FRASER: I understand the R.C.M.P. are very much aware of what is going on but with lack of law enforcement the Provincial forces are having a hard time, but nevertheless that sort of thing is going on.

COMMISSIONER WALLS: I take it you don't think we should get the addresses?

MR. FRASER: This is going on today in Canada

but it is happening in the U.S.A. Seven years ago the D.B.I., Licensed Beverage Industries and the D.S.I. who are our opposite number in the U.S.A. figured out of four bottles of spirits sold one was a bootlegged bottle.

THE CHAIRMAN: That is in the United States.

MR. FRASER: That is in the United States.

THE CHAIRMAN: This is very apparent in the United States and I wouldn't have very much trouble accepting it. I have been in the mountains of North Carolina and Kentucky and you can see the stills. They are all over the place and I would assume that is the case. I haven't seen it in Canada.

MR. FRASER: That is happening right now.

COMMISSIONER WALLS: Wouldn't you eliminate a lot of the sale of illicit liquor if in the main cities one liquor store was left open all night? Isn't that when the majority of illicit liquor is sold?

MR. FRASER: I would say so. We have asked the Liquor Commission for that particular purpose to stop taxi drivers buying supplies and selling it at 12 and 1 o'clock. Nearly every Liquor Commission now has a store open to 10 o'clock at night. In Vancouver it is open to 2 o'clock and that stops a lot of the nonsense of taxi drivers going in and buying a case and getting a call at 11, 12 or 1 o'clock for a bottle and selling that. I don't think it would stop illicit alcohol.

COMMISSIONER WALLS: I just have one further question dealing with this percentage of the tax on the absolute alcohol between spirits and beer. Don't

you think this is an attempt by Government to continue creating non-regressive taxes. As beer is looked upon as a poor man's drink, that is one of the reasons why there is quite a spread in the amount of tax computed.

MR. FRASER: Mr. Chairman, don't forget that is the beer people's cry that it is a poor man's drink. You can go to the liquor store in a mill town and the people are not buying beer. They are buying spirits.

THE CHAIRMAN: Is it not true that during a depression the consumption of beer goes up, and spirits goes down which supports the proposition I have just heard?

MR. HERINGTON: If there was a Canadian whisky at a reasonably low price that would not happen.

DR. PETRIE: There was a poor man's whisky offered by the then Government of Ontario during the depression at a very low price.

THE CHAIRMAN: Was there?

DR. PETRIE: Yes.

THE CHAIRMAN: Is Canadian whisky by world-wide standards cheaper or expensive? It would have been my experience that it is cheap for the same quality, that one gets a good product in this country probably cheaper than one could get it in the United States.

MR. HERINGTON: There is a difference in proof strength.

THE CHAIRMAN: Take that into consideration.

MR. FRASER: No, any company that ships whisky to the U.S. in bottles whether 86.8 American proof or 90.4

Americanproof he still has to pay his full proof gallon, $10.50.

COMMISSIONER WALLS: There are two grounds there in talking of the disparity between the percentage proof between Canada and the United States. We in Canada and also in the United Kingdom sell uniformly at 30 per cent under proof, I believe.

MR. FRASER: That is right.

COMMISSIONER WALLS: And that proof in Canada is 57.1 per cent alcohol, so that brings it down in a bottle to about 40 per cent alcohol.

MR. FRASER: 40 per cent of absolute alcohol per bottle.

COMMISSIONER WALLS: That is right. In the United Kingdom it sells at a higher hundred proof than we have, most of it is 90 per centproof.

MR. FRASER: No, sir, sorry.

COMMISSIONER WALLS: 85 to 90.

MR. FRASER: No, in 1914, 1915 the British Government brought strength of proof down to thirteen hundred, what we call thirteen hundred or seventy degrees proof. There it has remained in the United Kingdom ever since.

COMMISSIONER WALLS: The United States.

THE CHAIRMAN: You said the United Kingdom.

COMMISSIONER WALLS: I am sorry, I meant the United States. In the United States their proof spirits only contain 50 per cent absolute alcohol to our 57.1. As most of their alcohol is sold at 85 to 90 proof in the United States it works down that they have an average

alcohol content of 45 per cent as against our 40 per cent so there is really very little difference.

MR. FRASER: The American system of measuring proof is entirely different to the British system. You get American 80 proof identical to our 70 proof.

COMMISSIONER WALLS: Yes, that is right. I realize that. That is why I say their proof is 50 and ours is 57.1 per cent alcohol, but it works down with the amount of liquor you get in the bottle that there is less than five per cent difference in the amount of alcohol between the United States and Canada.

THE CHAIRMAN: Did you come to the conclusion the Canadian whisky is a good bargain or not?

COMMISSIONER WALLS: Yes, sure it is.

MR. FRASER: In the States?

COMMISSIONER WALLS: Yes, any place I have bought it.

THE CHAIRMAN: Say in Canada?

COMMISSIONER WALLS: Do you want me to talk as a Commissioner or as a consumer?

THE CHAIRMAN: I don't want you to talk at all. Have you any further comments on the question of whether Canadian whisky compared to whisky sold in other countries, Canadian-produced whisky compared to whiskies produced and sold in other countries is a fairly good bargain? Do you want to say it is expensive?

DR. PETRIE: It depends on the country. I could buy V.O. in the West Indies for $3.50. I pay $5 for it here.

/RPS

And in any monopoly state in the United States, Canadian whisky is much cheaper than it is in open States.

THE CHAIRMAN: Is that so?

MR. FRASER: Very much so. In the State of Vermont a bottle of V.O. is about $5.30. If you go further into Massachusetts you pay $6.30, $6.50 for that same bottle of whisky.

THE CHAIRMAN: You mean when there is free competition the prices goes up, because the open States are where there is competition between the vendors? Is that not right?

MR. FRASER: That is right.

THE CHAIRMAN: That is a rather extraordinary conclusion isn't it?

MR. FRASER: I don't think it is so much a matter of price in the States, I think it is a matter of quality. Canadian whisky is a very exceptional product. Canadian whisky is anunique whisky. No other whisky in the world like it.

COMMISSIONER WALLS: And you have the advantage of the date of it being on the tag.

MR. FRASER: That is true.

COMMISSIONER GRANT: If the industry were to receive relief in a manner in which we have not yet considered, but which comes out later in Dr. Petrie's brief, namely a reduction in the corporate tax rate, would it be likely that it could apply generally to the distillery industry, the benefits, insofar as passing that on to the consumer is concerned or would there

be some distilleries that would feel they were not in a position to pass that on, that they needed that to expand and improve the efficiency of the plant, and so on? Would you like to give any expression to that Mr. Herington?

MR. HERINGTON: Well I find that a little difficult. In our case we pay a very high rate of dividend in relation to earnings. If our corporate taxes were less, I would be inclined not to increase the dividend if we could then find other uses for the funds.

COMMISSIONER GRANT: There is no way of giving a statement to that effect? Giving a statement in answer to that question that would be of general application to the industry, I suppose? In other words, it is a means of, a direct means of increasing the earnings of companies engaged in the distillery business. If that would be possible in the form of a lower price, or passed on to the shareholder by way of increased dividends or retained in the company or divided among those three sources in various proportions, you would of course still think it is a matter for the individual company to decide?

MR. HERINGTON: It would change the conclusion in considering any development, either in Canada or abroad; establishing an organization. You relate what it is going to cost you to do it and the elements of risk with the return and it would certainly make it more attractive, from our point of view, to carry on with certain expansion which we have considered

and have not considered worthwhile at the present time. I think that would be a reasonable factor in our balancing up of the pros and cons of whether or not to make an investment.

COMMISSIONER GRANT: Which you can only do today by reducing your return to your shareholders?

MR. HERINGTON: Yes.

THE CHAIRMAN: We will now break for 10 minutes. Before we do though, I might say that completes our questions on the first 12 pages which we found very interesting indeed. Would you have anything to add in respect to that? If you had, perhaps when we come back you may put them. Let's leave them over any-way until we come back.

---A SHORT RECESS.

---FOLLOWING THE SHORT RECESS:

THE CHAIRMAN: Now we have nothing else on the first 12 pages. Is there anything you would like to say to us?

MR. HERINGTON: Mr. Chairman, I would like to first say we appreciate the attention you have given today to our submission. I have nothing new to add. I think in summary that we feel that we represent worthy corporate citizens and do generate substantial revenues on the foreign exchange so that what we are saying basically is that we think we are over-discriminated against.. Perhaps in the nature of things there will always

be some discrimination but in the far distant future it goes a little too far and that it is unfair in, for example, the sales tax being applied to the duty-paid value.

We would rather have it stated that the sales tax is not eleven per cent for us. It's 22 or 30 per cent. We would rather have that. We think it would bring it out in the open and be beneficial in the long term even if the amount were exactly the same as it is now but on a different basis. I think that that is our feeling, that we do not expect to be treated as handsomely as we would like, perhaps, but we think discrimination has gone too far. It is partly hidden.

THE CHAIRMAN: Thank you. We are much obliged to you for your help this morning. We will certainly continue to consider what you put before us. Thank you very much.

MR. HERINGTON: Thank you.

THE CHAIRMAN: With that, we will turn now, if we may, to Dr. Petrie and we have questions which we would like to ask you, but before doing so is there anything you would like to add to what we now have?

DR. PETRIE: The only thing, Mr. Chairman, is I gave you my calculations as to the revenue gains and losses from the implementation of the major proposals contained in the submission. This took some fancy footwork in their estimates, but I was loath to come before you without giving you a balance sheet accounting of what my recommendations involved and you have them, I believe now. That's about all.

THE CHAIRMAN: Thank you very much. I wonder whether a fair starting point might be actually to run down these valuations because that is new material. We have not really had a chance to assess it. If we get these figures in our minds, it will lead us to other things, I think, within your volume here.

Now the first item is computed on schedule one attached at 42-1/2 million dollars and it is a calculation which you have set out. 40 per cent ceiling seems to affect every classification here and I can understand. I think it would.

DR. PETRIE: 45 per cent sir becomes effective at 15,000, so from 15,000 up every group is affected by an overall ceiling of 40 per cent. Now this represents a little bit of an anomaly in that I had to use the 1960 figures for income, the numbers of taxpayers and taxable income, and income per capita for 1960 because there are no more recent figures available. The Green Book 1962 gives the 1960 taxation figures but I did use the 1962 tax rates against the 1960 income classification.

This is very rough, but this is the best I could do.

THE CHAIRMAN: Thank you. They are probably not very far out.

DR. PETRIE: I think they are not too far out but they will be -- but the yield of personal income taxes in fiscal 1962 was less than it was in fiscal 1960.

THE CHAIRMAN: Corporation tax means that you

took one per cent as being 11.74 million, and I see 10 per cent reduction -- 10 per cent each point isn't it?

DR. PETRIE: 10 per cent each point, yes.

THE CHAIRMAN: From 50 down to 40?

DR. PETRIE: Yes. That 10 per cent across the board reduction was calculated on the 1962 yield. Arithmetically it comes out to the same, whether you take the gross yield of a billion one hundred and seventy-four million, and take 10 off that or, as I did to satisfy me, take 10 off the other bracket and then add it up. It comes to the same thing.

THE CHAIRMAN: It does come to the same thing?

DR. PETRIE: Yes.

THE CHAIRMAN: I was really speaking of No. 3 a minute ago. Okay, No.2 I can understand that. No. 3 is set out on schedule 2 and is reduction in corporation taxes and is 10 per cent each point in the corpporation tax rate?

DR. PETRIE: Yes. Now in 1960, 22.3 per cent of the corporate income was subject to the lower rate and 78 per cent was at the higher rate and I have to assume that roughly that same rate relatively applies at present, so I applied that to the corporation profits taken for 1962 from the National Accounts.

Footnote A says that the corporation profits figure in National Accounts is not identical with taxable corporation income but differences are not great. National Accounts figures are always adjusted. Again, this is rough, but it gives you an approximation

of the revenue loss if you have a flat 40 per cent and as you will see when we may be discussing this later, I am arguing that the corporation profits structure does not lend itself, in my personal view, to rate differential or rate graduation.

This is not a new thing. That is why I am asking for a flat rate.

THE CHAIRMAN: Now you are taxing certain services here?

DR. PETRIE: That is right sir.

THE CHAIRMAN: You quite arbitrarily selected certain ones and dropped other ones?

DR. PETRIE: This was done, well, flying by the seat of my pants, to be perfectly frank with you, from the point of view of administrative feasibility of getting all these services, including the advantages and disadvantages of bringing services in.

2 Now I want to point out to you and your colleagues that these items of consumer expenditures, as contained in National Accounts 1962, page 58, fall under a subheading "household expenditures". You see fuel, electricity, gas, telephone and transportation as enumerated in the National Accounts do not include such items of expense by business enterprises.

These are household expenses so that my proposal on taxing these results in no increase in the cost of doing business, tax-wise. This is an increase in the cost of operating a household.

COMMISSIONER WALLS: May I ask you this question: under the transportation, dealing with the

cost of living index, does that not include automobile transportation, which is already subject to heavy tax? Gasoline and fuel is already heavily taxed?

DR. PETRIE: Yes. I am not sure of the background. Your economists will probably know more of this than I. In the National Accounts this specifies streetcar and other transportation of personal nature and I would presume that perhaps automobile transportation is in there but I don't know.

Although I have written to D.B.S. to get clarification, I haven't had a reply from them. I am certain someone in your Secretariate will know the answer to that.

Again, there is a weakness in this calculation which I must certainly point out. You will notice that these are taxed at eleven per cent. I just cannot work out what a manufacturer's cost would be, so that we could put a manufacturer's tax on these services. I cannot do it. I just haven't the mental capacity.

THE CHAIRMAN: You mean you consider that if it is eleven per cent at the manufacturer's rate, the household rate ought to be five per cent?

DR. PETRIE: It should be somewhat less, I think.

THE CHAIRMAN: Do you find that most countries tend to tax services at a lower rate than they do goods?

DR. PETRIE: That is correct.

THE CHAIRMAN: I don't know what the rationale of that is. I haven't been able to discover it.

I have asked that question and nobody has been able to give me an answer.

DR. PETRIE: I have done the same. Going back historically, you will all remember that during the Second World War when the manufacturer's sales tax was eight per cent, I remember living in Ottawa here. I had an eight per cent tax added on to my electricity bill from Ontario Hydro. It just took it at the manufacturer's level and stuck it on the retail cost of hydro services in the City of Ottawa. I presume it was the same all across Canada.

COMMISSIONER WALLS: When you deal with utilities, in effect, of course, the manufacturer is also the retailer isn't he?

DR. PETRIE: Yes.

COMMISSIONER WALLS: A number of provinces, of course, also have their own sales taxes on these utilities?

DR. PETRIE: On some services, that is correct.

THE CHAIRMAN: In this case, where a manufacturer is also the retailer under our existing system we use discounts so as to, in effect, bring it down to eleven per cent or something lower than that.

DR. PETRIE: I merely wanted to point that out, Mr. Chairman. It is a weakness, in my opinion.

THE CHAIRMAN: Now how about miscellaneous services which are usually referred to, ~~as~~ such as the shoeshine boy, the barber, bank interest, insurance?

DR. PETRIE: They could be brought in. I

argue in the text of this document, when I talk about the pros and cons of a retail versus manufacturer's tax. At the retail level, you have the virtue of being able to reach any service you want to reach rather easily.

The shoeshine boy, the fellow who cuts your hair, they can all be brought into the pot. My difficulty in this case was simply from a point of view of administration.

THE CHAIRMAN: Would you give it a distinct and separate tax on services, Dr. Petrie?

DR. PETRIE: That is right.

THE CHAIRMAN: It could be a different rate?

DR. PETRIE: That is right.

THE CHAIRMAN: If that were done, of course, one could quite easily tax all these kinds of things we are speaking of?

DR. PETRIE: Quite. I didn't want to clutter up my calculation with all these other things, bearing in mind you probably would ask that question and if you asked my opinion, I would say that I have not come to a definitive conculsion but, on balance, I would not object to a special measure on services which would not fall under the manufacturer's sales tax.

THE CHAIRMAN: Of course, many people have said to us that services should be taxed. I am not sure that any two people agree as to exactly what those services are, because they are broad?

DR. PETRIE: Yes.

THE CHAIRMAN: It was very easy to recognize

the barber and the shoeshine boy.

DR. PETRIE: You come to a choice; it's very complex once one gets into such matters as interest on savings.

COMMISSIONER WALLS: One other question about this, while we are dealing with it, and that is that further in your brief you are not in favour of taxing of the tools and implements of production. Well aren't you, in effect, creating the same situation if you tax electricity and telephone and such services as that? Aren't you going to place our producers in an equally adverse position.

DR. PETRIE: No. These figures, Mr. Walls, are only household expenses.

COMMISSIONER WALLS: That is what I am trying to bring out. Isn't it easy to apply it to household bills, and not to manufacturer's bills for power?

DR. PETRIE: That is right.

COMMISSIONER WALLS: Thank you.

THE CHAIRMAN: When you speak of electricity, I wonder whether you have in mind at all -- you may have from other parts of your brief, the representations which have been made to us on at least two occasions that income tax on utilities should be replaced by an end use sales tax. Would this achieve that result? You see the purpose of it don't you?

DR. PETRIE: Yes.

B/RPS

MR. HERINGTON: Yes.

DR. PETRIE: I want all corporate enterprises taxed at the same rate and on the same basis.

COMMISSIONER WALLS: Including provincially owned corporations?

DR. PETRIE: I didn't say that.

COMMISSIONER WALLS: You said "all".

DR. PETRIE: I didn't say it in the brief, but I will say it here in this room, I do agree with that, recognizing the political dynamite involved.

THE CHAIRMAN: We are not going to ask you to solve the constitutional problem. Obviously there is one.

DR. PETRIE: The fact Federal Crown companies are taxable I think paves the way for bringing provincially and municipally owned companies in.

THE CHAIRMAN: With your $188.9 billion dollars in service you put in here you haven't estimated and I have no idea what others should be brought up, but we have heard a much larger figure.

DR. PETRIE: Could be very much larger, Mr. Chairman.

THE CHAIRMAN: Now, your item No. 2, revenue gain from withdrawal of 1963 tax incentives. I presume you got that from the 1963 Budget; is that right?

DR. PETRIE: Yes, Mr. Gordon said in his Budget speech in a full year the incentive would cost revenue $100 million dollars.

THE CHAIRMAN: Your credit union is estimated on schedule 3 which we haven't yet seen.

DR. PETRIE: Here is where we really start flying on the seat of our pants.

THE CHAIRMAN: The seat of your pants is producing $28 million dollars; is that correct?

DR. PETRIE: That is right.

THE CHAIRMAN: That is not paid?

DR. PETRIE: Expensive seat. This was done on, perhaps, a questionable basis. The Ontario Credit Union League did make a submission to your Commission, sir, in April in which they did show net earnings of $12.5 million in 1961 which represented 4.7 per cent ratio to their total assets. In no other case have I been able to find the net earning figures revealed by credit unions. There may be some in existence but I haven't seen them. We do however have in the credit unions for Canada 1961, a publication of the Canadian Department of Agriculture, the total assets of all credit unions in Canada of one billion five. I think you could assume that all credit unions would be about 4.7 per cent of their assets. Well then I could find $28 million if you had my suggested rate of 40 per cent of corporate income.

THE CHAIRMAN: That is very interesting indeed.

COMMISSIONER WALLS: Your 40 per cent is a flat rate?

DR. PETRIE: Flat rate.

COMMISSIONER WALLS: You are not going to have two rates?

DR. PETRIE: No, sir.

THE CHAIRMAN: The profits of credit unions, of course, is before any form of dividends, isn't it?

DR. PETRIE: Yes.

THE CHAIRMAN: So you come out with a surplus of gains over losses under your proposal of 75.8 million dollars?

DR. PETRIE: That is correct, ignoring any figure that might be picked up if co-operatives were taxed in exactly the same manner as other corporations. I can't figure that out. I have been trying for weeks. I have left it, frankly, but there is obviously a plus figure if co-operatives were denied the three-year starting up exemption they now have and discontinue the preferential tax treatment they now have with respect to patronage dividends and there would be anywhere from five million or twenty million or thirty million plus. For my own purposes I say roughly if we could get all these in the Statute Books of Canada we could see one hundred million dollars more there.

THE CHAIRMAN: You recommend that co-operatives be taxed in the same way as corporations -- corporations be taxed in the same way as co-operatives?

DR. PETRIE: That is right.

COMMISSIONER GRANT: Dr. Petrie, I was wondering about the inflationary effect which this additional tax on the consumer expenditure might have and whether or not there is -- you see any great danger where increasing, directly increasing the cost of living could set up another wage increase all around. There are wage increases, but perhaps you would relate

that to the savings which come about through decreased taxes in the personal income field and in the corporate field?

DR. PETRIE: Yes, Mr. Grant.

COMMISSIONER GRANT: Would you say that one equates the other?

DR. PETRIE: My argument very briefly is this, if there was a 10 per cent reduction in every income bracket of personal income for most Canadian taxpayers in the personal income tax level the savings of that 10 percentage points, you would offset or more than offset the additional cost of operating the household because of my eleven per cent or X per cent on these services. It is very easily reckoned. He knows what the telephone bill is, he knows what the electricity and the gas and fuel bills are, taken 11 per cent for all them. If he pays $1,000 income tax and gets $100 cut on that it will roughly equate.

COMMISSIONER GRANT: There is a danger I should think to the person who isn't paying income tax. He is going to be immediately charged with this additional consumer expenditure. He is going to say I am going on relief -- I am paying out more money therefore I should have relief.

DR. PETRIE: Getting back to the question of a person who doesn't pay income tax, he isn't in a bargaining position to increase his income. He can't add to income. He is the pensioner.

COMMISSIONER GRANT: What about the wage-earner?

DR. PETRIE: Most wage-earners are in the list of taxpayers, surely. I would be very much surprised if very many members of trade unions in Canada are not paying some personal income tax.

COMMISSIONER GRANT: I haven't any figures on it at all, but there are a great many who are not enjoying full employment.

DR. PETRIE: That is right.

COMMISSIONER GRANT: And your income, earned income as an employee could be below a certain figure but it is augmented by their own efforts in another way. For instance there may be a farmer or a fisherman and they are -- while their earnings from an employer are low they are subject to taxes while they are employed.

DR. PETRIE: Yes. There isn't any doubt in my mind that people get hurt no matter what you do. My theory, cognizant of the fact that the implementation of a proposal of this kind will hurt some Canadians, but I can't device any kind of ideal tax system that wouldn't hurt somebody and I think this is the minimal hurt because most people would benefit from the 10 per cent points cut in personal income tax.

THE CHAIRMAN: Now, that takes care of this document you have put before us. Thank you very much indeed. I was wondering how to proceed and I think perhaps what we might do is to take the different forms of Canadian taxes and discuss them, perhaps. They are listed in your index, starting at part three.

Perhaps even before getting to part three I want to ask you one question on page 35:

"weight of the tax burden". There may be others of a general nature before we get there. The weight of Canadian taxes in 1963, 21 per cent of the G.N.P. according to what you have given here. I thought the total in Canada was something like 25 per cent of the Gross National Product, but I don't remember where that 25 per cent came from. It is, perhaps national income?

DR. PETRIE: I think national income, yes.

THE CHAIRMAN: The table on page 37.

DR. PETRIE: Yes. In terms of national income it is 27.8 per cent.

THE CHAIRMAN: Yes.

DR. PETRIE: And national income, of course, for 1963 I had to estimate.

THE CHAIRMAN: If one compares that with other countries one finds out that it runs up a great deal higher in several countries, I think. I think perhaps it runs over 40 per cent in some European countries, probably not very many which causes me to be very curious as to why this would be the case because if one looks at the corporation tax the rates are about as high as they are anywhere in the world, I think. Our indirect taxes combined at Federal and Provincial levels are pretty high. I don't know what the Federal level is, but I suppose it might be six per cent or thereabouts, and some people said seven per cent they thought. If one adds that to the Provincial tax he gets twelve or thirteen per cent, in that order. I think there are very few retail taxes anywhere

which are as high as that. You have indicated that personal taxes are pretty high. Somebody else pointed out that capital taxes in this country are as high as they are anywhere, property taxes -- if one takes all this together why haven't we got the largest take of any country?

DR. PETRIE: I think there is a partial answer if you refer again to table XII on page 37 where I take total revenues which are roughly 33 per cent of the national income. In this country we have a large take-away from the Canadian public which isn't properly classified as taxation,liquor products, for instance -- 10 per cent of the Provincial revenues, current revenues on the average come from liquor products which I don't classify as tax. In this country revenues of all sorts are revenues from the public domains which fall outside the classical accepted formula for taxation but still represent money taken away from the public. If you want really to broaden this, that the total tax burden instead of 8.8 billion in 1963 is 10.5 billion or one-third of the national income I think this changes the picture.

THE CHAIRMAN: I think the one-third if you compare it with other countries isn't anything like the top of the scale.

DR. PETRIE: It is probably true in some countries.

THE CHAIRMAN: 25 per cent of our population file tax returns and you can find many countries where that gets up to about 50 per cent.

DR. PETRIE: In 1960, Taxation 1960 we have 4.4 million people filing personal income tax returns.

THE CHAIRMAN: My 25 per cent is a little high.

DR. PETRIE: Yes.

THE CHAIRMAN: Well, it is frequently a great deal higher than that.

DR. PETRIE: Another point too, that we meet in this connection, which I think is pretty important, is the factor that our cost of Government is not nearly met from the amount of money received from the people. I point out somewhere here that something like 40 per cent of the national income would be taken away if our Federal and Provincial budgets were in balance.

THE CHAIRMAN: Don't you make a point we must raise our taxes 16 per cent overall to balance our budget?

DR. PETRIE: To balance the budget, yes. With our deficit financing at Federal Government and Provincial levels, and many municipal levels we are living away beyond our means.If we had to raise money from the public to meet the actual cost of Government we would be up with France and some of the Western Eurppean countries in terms of the take-away from national income. What we are doing is borrowing to fill the gap.

COMMISSIONER GRANT: This is a very fundmental question to address to you, Dr. Petrie, I have

no doubt, but when would you expect our budget to come into balance?

DR. PETRIE: Not in the foreseeable future unless expenditures are kept in close check.

COMMISSIONER GRANT: So you attribute the increase in expenditures to the situation which has developed, perhaps, more than a falling-off in revenues?

DR. PETRIE: That is right. The rate of expenditures just keeps going up and up and up and everytime Parliament meets they find some new way of spending our money without increasing the tax rate proportionately.

COMMISSIONER GRANT: I don't want to take up your time discussing how budgets are made up.

DR. PETRIE: My time is yours, sir.

COMMISSIONER GRANT: But there is the element of capital expenditures, when capital expenditures are included in the budget figure that does seem to be very misleading, doesn't it?

DR. PETRIE: Yes.

COMMISSIONER WALLS: Another way of looking at it is to balance revenue against expenditures of current accounts.

DR. PETRIE: That is what I tried to do. I tried to stick to the current accounts. My figures in billions of dollars in deficit are current accounts. I am not including capital accounts.

COMMISSIONER WALLS: On page 9, paragraph numbered 13 you say:

"Basic to the tax principles outlined

"in this submission is the basis that as "far as possible taxation should be imposed "upon economic surpluses rather than upon "costs."

You are dealing with personal income tax here. Would you interpret that the income tax paid by the person taxable in the low income brackets is an economic surplus and if not on what basis of personal income does it become so?

DR. PETRIE: This is a very difficult question, Mr. Walls, certainly in the lower brackets there isn't much economic surplus represented in personal income. There is sacrifice there. It is only when you get into the income bracket where there is actually a surplus over the day to day expenditures to maintain the health and welfare of your family that you do get a surplus. Where that point is differs from family to family, from region to region in terms of different regional costs of living and so on. This is one of these broad principles that might better have been left out, but I wanted the Commissioners to understand that the basic premise of my whole philosophy of taxation is that we should try to reach surpluses rather than tax costs in a country like this which is so dependent for its survival on the export market where it is so important to have to costs low in competition with other countries.

COMMISSIONER WALLS: Well now, following the same line of thought would you then recommend an increase of the exemptions in the lower brackets?

DR. PETRIE: I think certain of the exemptions or deductions -- I am not certain I would change the exemptions, but some of the deductions might be increased. I think deductions for dependents, for instance, are no longer realistic in terms of the cost of the dependent to the head of the household. That might be increased.

COMMISSIONER WALLS: In your brief you are going to reduce the maximum rate to 40 per cent?

DR. PETRIE: Yes.

COMMISSIONER WALLS: You also talk about a reduction of personal tax in the medium brackets as well. Now, if you increase exemptions in any way on the lower brackets there is nothing on that balance sheet that you gave us that covers this loss of revenue.

DR. PETRIE: Because I am not specifically recommending any change of the present Tax Act, except at the rate level. I have stayed away from this. It is an open question to my mind.

THE CHAIRMAN: I would propose to move to part three. Does anybody have anything before part three?

COMMISSIONER WALLS: The corporation tax.

THE CHAIRMAN: That is the first bit of part three. There are five recommendations with regard to corporation tax, substantially lowering flat rates which means the elimination of the present low rate to small businesses and I notice that you say that the impact of it is now not particularly useful.

You are not recommending this elimination purely because of the administration, I take it?

DR. PETRIE: No.

THE CHAIRMAN: But it is generally true that small businesses are short of capital and it is also true that they have a more difficult time making profits than large businesses. This is perfectly apparent in statistics in taxation as anywhere else, I think. That being so is there not a good reason for making some kind of concession to generate more capital?

DR. PETRIE: Well yes, I think the case can be made in terms of the relief of small enterprises to have that lower rate but the way actually it works does not satisfy me because there is no reason why a corporation with a million dollars or $50 million profit should pay the low rate on that first $30 odd thousand and then when you start to differentiate, then you get into all sorts of ancillary problems and in trying to think this think through, Mr. Chairman --- all right, let's have a bang at it. Let's level it all off at 40 per cent as an interim measure and hope that we can get it down to 30 and if it were down to 30, I wouldn't worry too much about a small enterprise.

Certainly if it were 50, I wouldn't recommend 50, that is for an across-the-board flat rate for an enterprise. This, I think, is basically wrong. 40 will create some hardship.

THE CHAIRMAN: But at 50, you would take a lower rate for small businesses?

DR. PETRIE: I think so, because 50 per cent of a small business is strictly murder.

THE CHAIRMAN: Rather than having a lower rate on his profits, your thought is you could have a lower rate for a small business?

DR. PETRIE: Just for small businesses.

THE CHAIRMAN: It's a matter then of defining a small business?

DR. PETRIE: That is right. Here you come into the problem of definition again.

THE CHAIRMAN: And that is not easy.

DR. PETRIE: Of course not.

THE CHAIRMAN: It is a very different solution to that which we have now.

DR. PETRIE: Yes.

COMMISSIONER WALLS: In arriving at your decision to change to a flat rate of 40 per cent, I notice that you quickly eliminated the suggestion of the tax being taken off corporate profits and you mentioned a revenue loss of over one billion dollars.

Now I don't see how you arrive at that because surely if you lost that revenue of one billion dollars in corporation taxes, you would make it up on the shareholders; on their income tax wouldn't you?

DR. PETRIE: Not if you -- yes. I am not certain though how much of it you would make up and I am not certain that I can support the contention of my learned friend from Montreal who has appeared twice before you advocating elimination completely of the corpororation income taxes. I could argue in theory that corporate income, as such, as not a proper vehicle to bear taxation, but it is now an established institution in our tax structure. I am trying to be practical and I don't think it is practical to recommend to any Government in Canada the complete abolition of corporate income tax.

COMMISSIONER WALLS: Of course, I was not asking you that on that standpoint at all. It was merely the fact you said it was a one billion dollar loss of revenue. I presume if it was passed on to the shareholders, or a big portion passed on to the shareholders.

We would also automatically eliminate the 20 per cent dividend tax credit.

DR. PETRIE: Mr. Walls, my roadblock there, in trying to take that one through is I don't know how much of it would be paid out in dividends. The pattern in this country has been in the past, and not only in this country but in the United States, to retain a larger proportion of your profits than are distributed, and if there were no corporate income taxes, I would suspect corporations would not change their traditional dividend policy and would just plow it back tax-free and expand and expand and expand and we wouldn't get any revenue from that.

COMMISSIONER WALLS: No, but of course the participant you were mentioning a few minutes ago did not recommend that there be machinery set up to prevent the retention.

THE CHAIRMAN: Machinery being a very high tax on undistributed income.

DR. PETRIE: That is right. Retained earnings are the major, if not the sole source of funds for the small enterprise and if you single out retained earnings for a special tax, such as the American Government did many years ago, then you are going to hurt the little fellow whom I am trying to help.

THE CHAIRMAN: Then to follow through on your first recommendation, I think a modification of the recommendation you are talking about, namely, if the corporation tax is maintained at a pretty high rate, we carve out, or we distinguish the small businesses

from the large ones and tax them in somewhat different way.

DR. PETRIE: That is right.

THE CHAIRMAN: And of course that could be extended not just to the corporation taxes but be extended to special taxes on undistributed income or anything else. The main difficulty with it is to pick out the small business, I think.

DR. PETRIE: This is the problem.

THE CHAIRMAN: On page 49 you say on the table at the bottom, contrasting the financing by bond and by stocks.

DR. PETRIE: Yes sir.

THE CHAIRMAN: And you point out that the financing by bonds exceeds that of stocks but I am not sure that it is a fair comparison, because I would think that to the extent that there is internal financing or plowing back of profits, that is being added to the equity of corporations and while what you say is statistically accurate here, I cannot quarrel with it, but it seems to me a better comparison would be an increase in the equity, as against the increase in debt and if one does that, you would have contrasted the issue of bonds, with not just the sale of stock, but the sales of bonds, and the accumulation of profits

DR. PETRIE: Yes sir. The only purpose for this exercise was to show (a) that there is a limited amount of external financing done in relation to the total and that the limited amount is pushed over in favour of debt financing versus equity financing.

THE CHAIRMAN: That is what I am quarreling with. What you say is true, but I think when one comes to make a choice as to whether he finances by debt or by equity, he must have regard not just to what may be the advantages and disadvantages of the sale of the bonds and sale of stock, he must also have regard to the composition of his own company. He must have regard to the proportion of the wealth of that company represented by debt, and the wealth proportion which is represented by capital. Based on that his judgment is going to turn a great deal as to whether he seeks to sell bonds, or to sell stock and if he has accumulated a lot of profit, and he is getting a large equity, he might well decide to sell bonds where he would not decide if he hadn't that equity.

DR. PETRIE: I agree.

COMMISSIONER GRANT: Then, of course, there is the very dominant factor that enters in there that if he is financing by the sale of bonds, he is able to deduct before tax the interest which he is paying on his money and he is eventually going to, on a funded basis, eliminate the debt and strengthen his equity position. In other words, he is going to pay off the bond issue.

COMMISSIONER WALLS: If he does it through equity, it could be a millstone about his neck at all times. It stays with him.

THE CHAIRMAN: Let's go to that then and see what the taxation advantage is as between the financing by debt and financing by equity. On the one hand,

as Mr. Grant points out, you have deduction for interest. On the other hand you have the dividend credit.

DR. PETRIE: There still is a definite tax advantage to financing by bonds because you do deduct, as Mr. Grant said. At present rates, it's half the cost of your financing.

THE CHAIRMAN: The other side of that, you lose the dividend credit?

DR. PETRIE: It's only 20 per cent.

THE CHAIRMAN: It's a very important matter to the shareholder. That 20 per cent may represent half his tax.

DR. PETRIE: It may.

THE CHAIRMAN: Or more with a small taxpayer.

DR. PETRIE: But my hunch is that most of the recipients of dividends are in pretty high brackets.

THE CHAIRMAN: Oh Dr. Petrie no. If you take the total of all shareholders across Canada, you will find that the average wealth of all shareholders across Canada is not very much. Am I not correct?

DR. PETRIE: You have variables as to the blocks of stock held. You have a number of shareholders but regardless of the number of shares they hold -- all I am saying is that probably, and I have to say probably, a heavy preponderance is owned by a minority of high income people. We all know in the Bell Telephone Company and in many other companies you have employees who have incentives to buy shares but they don't hold many.

I can name you one or two large investors

who probably have, between them, say three between them, as many shares as all of the employees of the company.

THE CHAIRMAN: I have found -- my experience is very limited -- that those directors, in making a choice, are pretty strongly influenced by the effect of whatever they are paying out to their shareholders and they usually show great concern on the small shareholders influence. They like their stocks spread. It is not altruistic; it's with the hope that they are going to add a number of shareholders when they make an issue and so they try to design it in such a way as to add shareholders and they are more apt to add shareholders if they have a dividend credit. If they don't -- I am arguing with you. I am sorry. I am really doing that to try to draw out your opinion, but I think I have your opinion.

DR. PETRIE: Right sir. Just one final comment: net new issues ( ) of stocks and bonds from 1956 through to 1962, as shown on page 50, 12.9 per cent of the total new issues to fixed capital formation.

In other words, we finance really by offering to the public.

THE CHAIRMAN: Thank you. You at some point recommend the elimination of all incentives. At the end of page 55 -- I don't see it. Of course, I note that in a hundred million dollars -- that pertains to 1963 tax exemption?

DR. PETRIE: That is right.

THE CHAIRMAN: Are you not extending it to other incentives too?

DR. PETRIE: Yes.

THE CHAIRMAN: Well wouldn't there be a gain from the other incentives?

DR. PETRIE: There would be, but I have no way of calculating what it would amount to.

THE CHAIRMAN: And if you can, in the elimination of the other incentives -- do you remember the reference in here?

DR. PETRIE: I remember it, but I am not certain where it is.

THE CHAIRMAN: I thought I did too. I was thinking of the extractive industry particularly and I think you made reference to extractive industries, the three-year exemption period, depletion -- I wanted to be sure I understood just how far your recommendation went.

DR. PETRIE: Page 119, at paragraph 156 there is (a) elimination of all tax incentives. That is a flat statement. Now in this recommendation I did not mean to imply that the existing special allowances in the extractive industries be repealed, with the simple exception that I do not feel that a three-year tax holiday for mining enterprises is warranted nor a three-year tax holiday for any other new enterprise but I would not touch it because it is so technical I do not feel competent to deal with it. I would not touch the existing special allowances for, say, the natural gas industry. What I am arguing about basically in tax incentives is the tax holiday treatment, the accelerated depreciation gimmicks and the kind of

incentive which is really an incentive of the 10 per cent proposed withholding on 25 per cent beneficially owned Canadian companies versus 20 per cent non-beneficially owned Canadian companies and the incentive that has been given to co-operatives and to credit unions.

Credit unions are completely tax exempt. These are the incentives that I really mean. I am sorry sir I should have spelled that out more clearly for you.

THE CHAIRMAN: That is all right. Now I want to be clear I understand this. You say you would not touch the tax incentives, if that is what they are, because of your lack of technical knowledge. Does that mean -- that does not mean that you are in favour of them remaining or in favour of them being removed. It means you have not considered it?

DR. PETRIE: I am neutral.

THE CHAIRMAN: Now you did say that you were in favour of depreciation, recognized by general accounting principles?

DR. PETRIE: Yes sir.

THE CHAIRMAN: I think I would point out under the Canadian system, as it now exists, capital cost allowance is not that generally recognized any more by Canadian accounting principles because you will find most balance sheets contain a reconciliation between accounting and "capital cost allowance". Are you in fact saying we should give up Canadian capital cost allowance procedure and go to good accounting?

DR. PETRIE: That is right.

THE CHAIRMAN: That is a very significant

statement and I was not quite clear you meant that. To me there is an element of incentive in the Canadian capital cost allowance.

DR. PETRIE: There is.

THE CHAIRMAN: I think most people agree with that. You say there is?

DR. PETRIE: Yes.

THE CHAIRMAN: So it would be your view we ought to take that incentive out and go back to what one acknowledges to be good accounting?

DR. PETRIE: That is right.

THE CHAIRMAN: I would think the only administrative way to do that is to restrict capital cost allowances to what the taxpayers put on their books. Am I right?

DR. PETRIE: Yes sir.

THE CHAIRMAN: I don't think I have got any more questions with regard to corporation taxes, without going into too much detail. Supposing we move on to personal income taxes and it starts at page 56 and runs to page 65. The conclusions start at paragraph 76:

"The heavy concentration of income "tax on the middle and upper income brackets "impairs the ability of Canadians to save . . ."

I have an idea that savings in Canada are going up at a pretty satisfactory rate. Am I correct in that?

DR. PETRIE: Last year they did but up until then, for a period of years, they had never

recovered their earlier figure. Now in footnote 26, page 64, it says:

> "The relationship between personal "income tax and personal net saving has "been as follows:"

And back in 1948 or 1949 when we had the post-War tax reduction, you see the savings on the per cent of income tax were quite high. Back in 1926, when we had virtually a nominal tax, they were fantastically high. Now they have been running -- there were considerable tax increases after 1954, and after that they have been running 70 per cent, 77 per cent.

THE CHAIRMAN: Having regard to these figures, one can eliminate, don't you think, 1926 and 1936 because the tax rates were very light?

DR. PETRIE: That is right.

3/RPS

THE CHAIRMAN: When you come to 1948 and 1949 were we not then receiving back some of our forced savings?

DR. PETRIE: I don't think in 1949. In 1949 Mr. Abbott gave 20 per cent reduction across the board on personal income tax which was rescinded right after that by the outbreak of the Korean War. There was that period when we had the 20 per cent flat reduction. This had nothing to do with compulsory savings during the war.

THE CHAIRMAN: Of course tax reductions would assume automatic increased savings. It takes people a little while to step expenditures up.

DR. PETRIE: Yes.

COMMISSIONER GRANT: The figures of personal savings, are these the bank accounts, are these actual personal savings accounts?

DR. PETRIES: These are estimates given in the National Accounts income and expenditure by the Dominion Bureau of Statistics. They have so shown personal savings.

THE CHAIRMAN: This wouldn't be bank accounts by themselves. This would be reduction in mortgages, insurance companies, mutual funds?

DR. PETRIE: Mutual funds, pension funds.

THE CHAIRMAN: Credit unions?

DR. PETRIE: Credit unions. It includes their estimate of all forms of personal savings, your insurance premiums and so on.

COMMISSIONER GRANT: I was going to ask you

Dr. Petrie would you attribute the percentage decline through the years of the savings as percentage of income tax, to the fact there is more opportunity today for investment in stocks and bonds and that the public are more conscious, investment conscious than they were in earlier years?

DR. PETRIE: I am sorry, Mr. Grant, I am not quite certain I understand your question.

COMMISSIONER GRANT: It is relevant to this table here on page 64. My question is that there is a decline in the percentage of savings as a percentage of income tax.

DR. PETRIE: Yes.

COMMISSIONER GRANT: I am wondering if that decline is due in some measure to the fact that savings are funnelled off into other types of investments today?

DR. PETRIE: They are still savings by the definition used in the National Accounts. It doesn't make any difference what form the savings take, they are still computed as savings.

COMMISSIONER GRANT: In other words if a person buys shares in the Bell Telephone that is taken in as a saving?

DR. PETRIE: I believe it is.

COMMISSIONER GRANT: Is it?

DR. PETRIE: I believe it is.

COMMISSIONER GRANT: I shouldn't have thought so. I thought savings would have been restricted to those types of depositories from which the monies can be withdrawn at any time?

DR. PETRIE: I am not certain of this, sir, but I believe that this would include purchase of bonds.

THE CHAIRMAN: Reduction of one's mortgage.

DR. PETRIE: Reduction of mortgages. The thing I think that was really significant in the series is despite the fact personal income has been going up and up and up between 1960 and 1961 you actually had a decline in net savings from a billion five three nine to a billion five zero nine. Since this was done we have the 1962 figures and there was a sharp increase in savings in 1962.

THE CHAIRMAN: Do you happen to know what the figure is?

DR. PETRIE: Close on to two billion, sir. I could give it to you, I think. I have the National Accounts here. Let us just look it up, if you will bear with me. National Savings Account Series page 34, personal net savings in 1962 was 2.3 billions. That is opposed to 1.5 billion in 1961.

THE CHAIRMAN: That is amazing!

COMMISSIONER GRANT: I still don't believe myself that personal savings take into consideration investments. I think that personal savings are gauged by what we regard as money set aside for pensions, money on deposit in banks, trust companies and so on.

DR. PETRIE: Well, when we talk to your economists perhaps some of them will know more about the composition of the saving than I do. If I were doing calculations I would include investments in saving.

THE CHAIRMAN: I think probably what Mr. Grant may mean when you take money out of the bank account and put it into a bond it doesn't increase your savings. I would agree with that, and you agree with it?

DR. PETRIE: Yes, I agree.

THE CHAIRMAN: It is just a change of one form of saving to another form of saving.

DR. PETRIE: That is right.

THE CHAIRMAN: When you put money aside it doesn't matter what form it goes into.

DR. PETRIE: I would argue with the Bank of Canada and I would argue with D.B.S. if they don't do it. I would argue they should. People who are buying regularly into mutual funds out of their earnings, this would be a saving because it is a saving in my view and there are many thousands of people who are making monthly purchases in mutual funds, largely common stocks. I consider that as a saving.

COMMISSIONER GRANT: I think mutual funds have cash surrender value to them.

DR. PETRIE: They have.

COMMISSIONER GRANT: As has an insurance policy, but has not a common stock.

DR. PETRIE: If the stock is listed it generally is a source of revenue.

THE CHAIRMAN: As far as definitions go, let us tidy this up later on, because I don't think we are too far on.

"The heavy concentration of income tax

"on the middle and upper income brackets
"impairs the ability of Canadians to save,
"in some cases reduces incentive to work".

We have asked questions about that and really haven't got any answers. Have you got any answers?

DR. PETRIE: I qualify and hedge by saying most people are not really affected in terms of their incentive to work.

THE CHAIRMAN: Is it good to increase incentives or is it good to reduce incentives, what is in the national interest?

DR. PETRIE: To increase incentives so we have got the national product up. People on salaries and managerial people, particularly the high income ones I think are not working for money. They are working for something else. There is a group of Canadians who definitely have an incentive to produce impaired by the present level of taxation and I may say so, if I may take the liberty of being personal that I am one of them. There comes a point when you no longer want to take on work that involves every night of the week and working on Saturday and Sunday, you turn away what could have been substantial fees simply because the Government takes too big a bite out of it and I put a very high value on leisure. I cannot surely be the only Canadian with this philosophy.

THE CHAIRMAN: Perhaps it is a good thing for us you are encouraged to take more leisure. I am not sure it is in the national interest to inspire you

to work 15 hours a day. Apart from you I think it is far more significant to go down to some average Canadians.

DR. PETRIE: I think the average Canadian's incentive to work is not affected by the income tax.

THE CHAIRMAN: You think it is not?

DR. PETRIE: No, it isn't. He is working forty hours. He is a member of a union or an executive man who has responsibility and he is going to work anyway regardless of the taxes. The self-employed, and I am now thinking of some of the natives, and my great friends in the Maritimes that close up shop in the summertime during the salmon fishing season maybe Friday morning or Thursday evening and put a sign in the window, "be back Monday". It just isn't worth their while to work when you can kill salmon in the summer and shoot partridge and duck in the fall. There is a limited group of people, and this is the only reason I put this in there -- I knew I would be challenged. I have been challenged many times before, but if you read some of the Budget speeches earlier you will see during the War Mr. Illsley referred to this crushing burden of taxation.

When he introduced his estate taxes he talked about the crushing burden of income tax and its bad effect on incentive to work. The Government officially recognized this quite recently when taxes were, perhaps, higher than they are today and with the do-it-yourself business -- I think from the point of view of the pure economic theorist it is a fascinating field. To use an example there are people who used to

go and work extra hours and get enough money to pay a decorator or a gardener to do your work for you, but it is great fun to do it yourself and maybe it isn't any cheaper, but you don't stay in the production line.
2 making that extra automobile or mining that extra three hundredweight of coal, you go home and paint your barn. Is this good or is it bad? It is a moral judgment I think.

Then we have absenteeism as we did in the Maritimes, in the Maritime coal pits -- I have first-hand experience of this. We had absenteeism because the man on piecework figured his rate of weekly pay to a certain point, maybe Thursday noon or late Thursday afternoon and this is take-home-pay so they knocked it off. This was a problem that bedeviled us in Ottawa when we were trying to get on with the War. I am not trying to make an issue of this.

THE CHAIRMAN: The more I see and hear of this the more puzzled I become. I can see the simple argument it does cause absenteeism. On the other hand I think it is in the national interest that people spend their leisure to better advantage. Again I am inclined to believe that high tax rates promote moonlighting. I am uncertain whether that is in the national interest. I suspect an awful lot of it is the type of work which evades taxation.

DR. PETRIE: Yes.

THE CHAIRMAN: And perhaps if it wasn't for high taxes it wouldn't be done. That operates in exactly the opposite way to which you are speaking of.

DR. PETRIE: It costs the revenue.

THE CHAIRMAN: Yes, it does, but it increases the G.N.P. by more people working.

DR. PETRIE: I am not certain that the people who estimate the G.N.P. take into consideration the value added by moonlighting.

THE CHAIRMAN: They take it in, the product is there and the work is done.

DR. PETRIE: That is right.

THE CHAIRMAN: You have in your summary indicated 10 per cent flat off all taxes. I don't see it referred to in the conclusion on page 65. Am I overlooking something there?

DR. PETRIE: I omitted to point that out to you, sir. That was an omission that got away from me. It was supposed to have been in there.

THE CHAIRMAN: It came at me as a surprise in your summary and I thought it was something I overlooked.

DR. PETRIE: It is not in the summary. In the helter-skelter of getting this thing put together I missed it.

THE CHAIRMAN: Is there anything else on personal tax? You haven't had much to say about taxing of the family as a unit, I don't think.

DR. PETRIE: No.

THE CHAIRMAN: Have you have views how the family should be taxed? Are you satisfied with the Canadian system?

DR. PETRIE: No, I would like to split income

between husband and wife as is done in the United States.

THE CHAIRMAN: You prefer that to adding them together as they have done in the U.K. and most European countries?

DR. PETRIE: I think so.

THE CHAIRMAN: How about splitting further than the man and wife by bringing in the children as they do in France? Have you considered it?

DR. PETRIE: I considered it but I decided to let it alone. I don't know enough about it. I would be happy if it could be split between the husband and wife. This is established in North American and it is quite simple.

COMMISSIONER WALLS: In the United States you understand the split doesn't matter very much until you get into the medium to higher brackets?

DR. PETRIE: That is right.

THE CHAIRMAN: Sales tax?

COMMISSIONER WALLS: The first question I would like to ask you, Dr. Petrie, in regard to sales tax deals with your figures of the $1,108 million in 1963 revenue including old-age security funds. Would you not also include excise taxes as sales tax?

DR. PETRIE: No, I am dealing . . .

COMMISSIONER WALLS: I am asking this for a reason. Would you not consider that excise tax is a sales tax?

DR. PETRIE: Yes, in fact.

COMMISSIONER WALLS: Well now, do you not see merit in having a graduated scale of sales tax that

will give higher taxes on luxury items? You understand I am not saying excise duty so you can talk a little more freely.

DR. PETRIE: I can talk as freely as you want me to talk. I may be forced in terms of pure theory to accede to the point. My roadblock in this is I cannot define luxury because what were luxuries a decade ago, a generation ago, two generations ago are now necessities. A flush toilet was certainly a luxury one hundred years ago. It is no longer a luxury. An automobile was certainly a luxury when I was a small boy. It is not a luxury, deemed a luxury by the average Canadian. It is essential.

THE CHAIRMAN: Can't you turn that around, that food at one time was considered a necessity. Now, beyond what is 1,500 calories a day it certainly is no necessity, and in fact, should be taxed at the highest rate of all.

COMMISSIONER WALLS: I think we better drop that subject. I am thinking of things like jewellery. Is there any reason that a straight luxury item, that you define as a luxury, should not carry additional taxes and if so shouldn't we think in terms of graduated sales tax that would include within the one tax what is today the excise tax as well as the sales tax?

DR. PETRIE: I wouldn't say all jewellery is a luxury. Certain the $10,000 string of real pearls might be a luxury. The diamond you give to the girl you are marrying as an engagement ring I don't think is a luxury. It is an accepted way of North American

life, yet a diamond is a jewel. You could argue this thing all night. I for the life of me can't even consider spirits as a luxury today when 70 per cent of the people are admittedly users of spirits and many medical people prescribe spirits for certain conditions, old-age, improved circulation and so on. You can extend these arguments. You can retract them.

For this reason I stay away from graduated tax, an ad valorem tax on commodities because I still don't know the borderline between what is a necessity and a luxury. Is a second car in your garage a luxury? It may or may not be. It may be strictly necessary if you are a suburbanite and need one to go to work and your wife is four miles from a shopping centre and she needs some way of going to the shopping centre. She could argue that is strictly a necessity.

COMMISSIONER WALLS: If we were to follow that through to the degree of assessing either what is a luxury or what the trade will bear we are immediately going to be faced with a loss of $275 million of excise tax.

DR. PETRIE: That is right.

COMMMISSIONER WALLS: Well then, I will jump to your paragraph 80 where you say:

"Pricing method of retailers and "wholesalers are such that substantial "pyramiding occurs."

Now, let us say a product costs the wholesaler $10 plus 11 per cent sales tax so it would

come to $11.10 as his cost. Then he adds 25 per cent margin of profit which means a mark up of $3.70. Have you any assurance if the tax is brought forward to the retail level as you suggest that the wholesaler wouldn't continue to take a mark-up of $3.70 or might not need to take a mark-up of $3.70?

DR. PETRIE: I have no assurance.

COMMISSIONER WALLS: Therefore there may be no pyramiding at all.

DR. PETRIE: There might not be.

COMMISSIONER WALLS: There might be no cure to what you call pyramiding.

DR. PETRIE: Presumptively I think there is pyramiding.

THE CHAIRMAN: I didn't understand that answer. There is a presumption to be a movement of pyramiding?

/RPS

I think the question Mr. Walls put to you, certainly the one I am interested in is whether you in fact believe that that presumption is borne out in practice? We have queried an awful lot of people with regard to their own industries and they all held to the mathematics, but I think they all had some doubt as to whether the profits of the people who are, supposedly, pyramiding their profits with taxes, would decline if the tax was withdrawn or the level changed.

Do you have any view on this? You must have considered it over the years?

DR. PETRIE: I have considered it, Mr. Chairman, and I would assume that competition would play a role here. It's like the corporation tax. When you ask certain corporations if corporation taxes were reduced by 20 per cent each point would your retail price be lower, would they remain the same, quite often, very often indeed, you get the answer: it depends upon what the competition does.

COMMISSIONER WALLS: In my next question I will be dealing with a case that you quoted in regard to pyramiding which, of course, deals with the distillery industry. First of all, though, do you agree that on imports into Canada the sales tax should be added to the duty-paid value of the product?

DR.PETRIE: I would rather that it weren't. I know that there would be numerous administrative problems in determining fair value laid down in imported commodities, ex customs duty, put the eleven per cent tax on what we might call an in-bond value

but preferably, in terms of tax equity, if we are to have a statutory rate of eleven per cent, I would like to see that rate be a real eleven per cent, not an eleven per cent on top of, shall we say for the sake of argument, a 30 per cent customs duty which pyramids it very substantially.

COMMISSIONER WALLS: Of course, the customs duty was, apparently, originally put into effect in order to bring the price up to where it was possible for a Canadian manufacturer to compete.

DR. PETRIE: Right.

COMMISSIONER WALLS: If you are going to charge the Canadian manufacturer sales tax on his manufactured price, then isn't it equally fair that you charge the importer on the equivalent price, which is the duty-paid value?

DR. PETRIE: No. Let's go back to this simple case, the one we have been talking about: whisky.

COMMISSIONER WALLS: I was going to lead to that one. Maybe I had better state what I have in mind first. You see right today on imported whisky you pay the sales tax on the tariff?

DR. PETRIE: That is right.

COMMISSIONER WALLS: The purpose, as I interpret it, of an excise duty was to create equity between the product manufactured in Canada and that imported. The fact that the excise duty is practically the same as the tariff on the imported product would indicate that and, therefore, if it is fair to put the

sale tax on top of the customs duty of the imported product, surely it is equally fair to put the salestax on top of the excise duty of the domestic product?

DR. PETRIE: I would put it the other way and say if we could have the sales tax paid on the in-bond value of imported whisky, we would be just as happy. Am I right?

MR. FRASER: That is right.

THE CHAIRMAN:: Take another commodity. I would have thought that if one applied the sale tax generally, without regard to duty, or on the value or purchase price before duty, it would give the importer a distinct advantage over the Canadian manufacturer -- and I am not talking about whisky. I am talking about other products -- because the duty is imposed in order to bring the price of what one imports to the equivalent of what is manufactured in Canada; particularly protecting the manufacturer. I would have thought the only point was the sales tax is at the point which includes the duty.

DR. PETRIE: Of course, by doing this you are actually making the effective rate of duty higher aren't you?

THE CHAIRMAN: No, I don't think so, because the tax is tax and duty is duty and if the tax is a revenue, for that purpose it should be imposed on the imported article at the same level in the distribution process, as it is imposed on the domestic level and I think probably it is if the duty is imposed.

DR. PETRIE: Let's take an article that has

landed here, before duty, at $100. Say the duty is ad valorem 30 per cent, sales tax is 11. It seems to me that if you paid the 11 per cent sales tax on the $100, then you have paid $30 on the $100 and you still get protection.

THE CHAIRMAN: I think it would be quite unfair, because the duty-paid value, although it is $130, presumably it is put at that figure in order to equate it with the Canadian manufacturer's price of something like $130 and if that is the point, if that is true, then we are imposing tax on the Canadian product at $130. Surely we should impose a tax on the imported product at something like the same figure?

DR. PETRIE: I am afraid I cannot discuss this very intelligently because I do not know whether the duty is set at a rate which is calculated to equate the cost of foreign goods with the cost of Canadian goods.

THE CHAIRMAN: I don't either. I was assuming that that was the intention of the duty, which was to try to protect Canadian products from imported goods; goods having the advantage over them. Therefore, if that is correct, the result that I spoke of should flow.

DR. PETRIE: I think that is probably right, except that I question the whole idea of levying duty on imported goods throughout the whole tariff schedule. You get all sorts of different rates. Whether they are meant to equate, some of them historically have been fantastically high, almost to the point of shutting out

foreign competition.

When Sir John A. MacDonald ennunciated his national policy early on in this Confederation of ours, he certainly was building a wall to protect Canadian manufacturers in order to develop the industry.

THE CHAIRMAN: The system may be imperfect, and probably is but surely one should recognize what the system is attempting to achieve and not deliberately turn his back on the system and go in the other direction.

The system can't be all that bad. If it is, we should tear it up and do something different.

COMMISSIONER WAILS: You recommend a joint Federal-Provincial sales tax. Now the Province has to rightfully bring it out. On page 72 you feel that the sales tax is the provinces particular preserve and yet the Provinces have never used that tax to any extent on the services that you mentioned. Therefore, have you any reason to believe, if you make a joint tax, that the Provinces will go along with taxing of services?

DR. PETRIE: No, I haven't and I think if I did recommend that there should be a joint sharing of taxes, it was hedged because I think I pointed out that with the two Provinces, Alberta and Manitoba still outside the retail tax field, it would be expensive for the Federal Government to shift over to the retail level and have to set up a whole policing organization in those two Provinces.

This would represent an extremely difficult problem in Dominion-Provincial relations. As you say, Mr. Walls, the Provinces have, for quite a long while,

been relying on retail sales taxes as a major source of revenue.

The exemption of services, I suspect, is being done largely for political reasons. These Provincial sales taxes have not always been popular. They have been responsible for toppling at least one Provincial Government, if not more.

They tried to make them as innocuous as possible, and yet get the maximum revenue yield that they could. If there were a Federal Act imposed, supposing for the sake of argument the Federal Government moved into the retail field, instead of the manufacturing field and they wrote an Act which said to the Provinces: all right; do you want to go along with this? We are going to tax certain services. You can set your rate. Our rate is going to be so and so. I don't know how many Brovinces would come into such a proposition. All I can foresee here is one very violent session between Ottawa and certain Provincial Government leaders.

COMMISSIONER WALLS: That is why I was rather surprised that you devoted a whole page to outlining these difficulties and then gave no argument as to the use of the compromise of, perhaps, a wholesale sales tax.

DR. PETRIE: I neglected to do that for the simple reason that I did not see that a tax at the wholesale level would solve anything in any way. You have the obvious difficulty of the manufacturing tax and the obvious advantage of it. You have the advantages of the retail taxes but if you start in an interim stage,

an intermediate stage with the wholesale level, I do not see that it would solve very many problems.

COMMISSIONER WALLS: You would move it ahead from the manufacturer's level and reduce some of the so-called pyramiding that you have mentioned?

DR. PETRIE: Yes.

COMMISSIONER WALLS: And also some of the disadvantages of arriving at an 'end use' with the manufacturer?

DR. PETRIE: That is right.

COMMISSIONER WALLS: And you would get away from all of these problems that you outline on page 72, in regard to gettting the Governments to go together so that is why I am rather surprised you did not at least consider that it was a good compromise, to consider a sales tax at wholesale level.

THE CHAIRMAN: And you also take care of most of the very clumsy discount system we have got in Canada?

DR. PETRIE: Through the wholesale?

THE CHAIRMAN: Yes.

DR. PETRIE: Yes, I realize that.

COMMISSIONER WALLS: Now my next one is rather to get something corrected for the record. You state on page 70:

" . . . a relatively large number of "gainfully employed Canadians pay no personal "income tax."

And then you have a footnote (32) in which you say farmers are a case in point. The total cash

income of farmers in 1960 is estimated at $2,860 million and that they only paid tax on $276 million.

Now you realize that the total cash income of farmers is exactly as if you went and said look at the little tax the Ford Motor Company pays, because they take in a gross revenue of this amount without making any deduction for the materials they buy, the amounts they pay out in labour. The only figure that should have been taken there is the farmer's net income. The farmer's cash income is before they pay for their labour; before they pay for their seed or pay for their feed and all the costs that went into farming. Now the actual figure of net income was $1,288 million, using the same year, 1960.

DR. PETRIE: It is a good point.

COMMISSIONER WALLS: Let me finish it. I want the record clear on this. In the 1961 census, there were 480,903 farmers and if you divide that into that net income, you then find that the average income per farmer was $2,680 and if that was the average income, then you can easily see why there was a limited amount of tax paid and quite probably no farmer escaped paying taxes that were due at all.

DR. PETRIE: Of course, the problem here Mr. Walls is income in kind.

COMMISSIONER WALLS: No, income in kind is included in these figures. The only thing that would not be included is, for instance, and this might interest you -- out of these 480,000 farmers, there were 120,000 of them who earned less than $1,200 from their farms

and these farmers would take off farm employment so there would be additional income from ~~all~~ other than farm employment but outside of that, the fact that the average income per farmer is so low I think would substantiate the fact that farmers are not escaping taxes. It is just the fact their earnings were such they were non-taxable.

DR. PETRIE: I could make some comment here but I think I had better be quiet.

THE CHAIRMAN: I don't think we will even ask you whether or not you agree with Mr. Walls.

COMMISSIONER WALLS: But you do agree you should not have quoted the farm cash income?

DR. PETRIE: That is right. That was an error. That was my error.

COMMISSIONER WALLS: On page 74 you point to the fact that we should place more weight on comsumption taxes and use France as an example. Is that right?

DR. PETRIE: Yes.

COMMISSIONER WALLS: Well do you think France was a very good example, considering that she had such a poor record in collecting personal income tax?

DR. PETRIE: Well I used the French situation because the argument by most of my colleagues in the field of economics has always been that commodity taxes are bad for the economy, and they are bad for the welfare of the people, and so on.

Here you have a country like France which relies very heavily on commodity taxes and yet the economy of France has been very very buoyant, despite this high level of tax and the heavy concentration of sales

tax and other commodity taxes. Despite this the French economy has been very energetic so much so that President Kennedy sent a team over there a year and a half ago to look at the reasons for it. What have the Frenchmen done that has been so hot and what role has the tax structure in France played, if any, in this resurgence of the French economy in the last five or six years.

This is the only reason I picked out France.

I say we in this country place far too much stress and reliance on the direct tax, corporate production and personal income. I am merely suggesting that we would be better off economically if we push the balance to the other side somewhere.

COMMISSIONER WALLS: I don't necessarily disagree with your findings but it does seem to me that one thing is perhaps overlooked: that France had to make a success of her consumption taxes because of the fact that she apparently only was able to collect 40 per cent of the income taxes that were due her for years. It was your example I was criticizing rather than your theory.

DR. PETRIE: I understand.

THE CHAIRMAN: I think I would comment on that also that I am not a bit sure that it was a lack of skill in collecting income tax. I do know, by virtue of the split which brings the children into it, that the income is reduced to such an extent a great deal of income is not taxable at all. As far as I know they all filed tax returns. There is a high performance when they file returns. Beyond that, I

believe that France has had a pretty severe dose of inflation.

DR. PETRIE: Recently this has been so.

THE CHAIRMAN: And that dose of inflation would have looked very nice indeed in the G.N.P. figures without adding real substance.

DR.PETRIE: Yes.

THE CHAIRMAN: I don't know whether anybody has tried to recast what the economy of France would look like without inflation. I don't know if it is possible to do so. Probably it would not be possible.

DR. PETRIE: I have tried, Mr. Chairman, to use deflaters but it is extremely difficult to do so. My experience with France admittedly is not first-hand. What I know is what I have read in the learned journals and tax papers; one thing and another.

COMMISSIONER WALLS: On page 69, paragraph 85 under the heading "tax equity" you deal with this being arrived at by means of exemptions.

You speak of sales taxes limited largely to consumer expenditures on clothing household furnishings, liquor, tobacco and durable goods such as automobiles. Am I to take from that that you favour an exemption of building materials?

DR. PETRIE: Yes, sir.

COMMISSIONER WALLS: For what purpose?

DR. PETRIE: I think that the inclusion of building materials in the tax structure is an added cost of doing business. This is one of the basic philosophies that I present to you, that I don't like taxes that add to the cost of doing business.

COMMISSIONER WALLS: But you wouldn't say that the building tax is necessarily a regressive tax, would you?

DR. PETRIE: It depends upon the type of building. It is in the case of cheap housing, that is housing say in the $10,000, $11,000, $12,000 level per unit, residential construction. It adds substantially to the cost to the consumer and these are the marginal consumers in our economy.

THE CHAIRMAN: You are saying you don't like this tax when it applies to production facilities; is that correct?

DR. PETRIE: That is right.

THE CHAIRMAN: But are you distinguishing between that and when the tax bears directly on consumer expenditures such as housing?

DR. PETRIE: I am distinguishing, but I find in the case of building materials it is extremely

difficult to draw the line. In principle I would oppose tax on building materials that go into the creation of fixed plant in order to produce goods. Again one is caught almost on the horns of a dilemma when you make that kind of statement and say what about low cost housing, are you going to pay eleven per cent tax on building materials on the $10,000 home? You just don't like it or I don't like it.

COMMISSIONER WALLS: I think an example of what you are saying is the fact that the first exemption that was given to sales taxes was on raw lumber and it was only the next year that lumber merchants were knocking at the door and saying when does it stop being raw lumber. We have doors of raw lumber. They got doors exempted and gradually it was built up. That seems to be one of the troubles against your increased use of consumption tax. Everybody seems to be quite keen we should use consumption tax provided we exempt the things they want exempted.

Now, if you start to define your building materials which shall be exempt or which shall not it is going to be no time at all before everything is back to where it is today.

DR. PETRIE: I agree.

COMMISSIONER WALLS: I am rather interested to know why you have such definite views on building materials?

DR. PETRIE: Again it goes back, because I suspect cost of building materials in this country represents the putting in place of plants for production.

I don't like extra costs on the cost of assets in order to produce the goods necessary for the prosperity of the nation.

THE CHAIRMAN: It would be my intention we will break now and come back here at 2:15 and that we Commissioners would get through with our questioning about half an hour after we come back. Mr. Fraser, you want to say something?

MR. FRASER: Mr. Chairman, I would like to ask Mr. Walls a question. This morning when we were discussing the distiller I understood you mentioned that the excise duty in the U.K. was something in the neighbourhood of $39?

COMMISSIONER WALLS: $29.

MR. FRASER: That is against our $17.

COMMISSIONER WALLS: Against your which?

MR. FRASER: Against our $17.

COMMISSIONER WALLS: I beg your pardon.

MR. FRASER: I mean against $13.

COMMISSIONER WALLS: 13, that is right.

MR. FRASER: That is perfectly true but we must realize that that excise duty that they have in the U.K. is the one and only tax. They don't have sales tax and they don't have Provincial mark-up.

COMMISSIONER WALLS: Is there not a purchase tax on liquor?

MR. FRASER: No, that is all. No sir, there is no purchase tax on liquor. That is all included. If you were to take our excise duty, $13 plus Provincial mark-up which we have here you would

see our taxes, Federal and Provincial-wise are considerably higher than in the U.K.

COMMISSIONER WALLS: Yes, I agree. If we go back to recognizing the Provincial mark-up as a tax you are quite correct.

MR. FRASER: Referring to the U.S.A. I think you mentioned something about taxes in the neighbourhood of $14?

COMMISSIONER WALLS: I beg your pardon?

MR. FRASER: U.S.A.?

COMMISSIONER WALLS: Put on a basis of Canadian gallons I think it works out as $14 and forty-odd cents.

MR. FRASER: I think, Mr. Walls, if you don't mind my saying this, I think you have taken the inland revenue tax as $10.50 plus import duty of $1.25. If you take the straight $10.50 inland revenue and equate that to our own Imperial gallon against their wine gallon in the actual quantum the U.S. tax, national revenue tax is just a few cents below our $13.

COMMISSIONER WALLS: I have no data with which to disagree.

MR. FRASER: I can understand where you got caught because I have been caught the same way myself.

THE CHAIRMAN: Thank you very much. Gentlemen we will stand over to 2:15.

---LUNCHEON ADJOURNMENT.

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---UPON RESUMING AT 2:15 P.M.

THE CHAIRMAN: Dr. Petrie, in our discussions this morning I think we had got down to estate taxes?

DR. PETRIE: That is right.

THE CHAIRMAN: Pages 76 and 77, and you suggest that the Federal Government abandon the estate tax without revenue loss and its abandonment would improve Federal-Provincial fiscal relations. Do you think the loss of that tax would be of any significance to the Federal Government as an instrument to assist in the collection of income tax?

DR. PETRIE: I don't know, Mr. Chairman. It is my impression that the reason for the retention of the tax has been a police measure more than anything else on the theory that if tax dodgers effectively got away with something during their lives the Revenue may catch up with their estates at death. This isn't necessarily so because if they spent what they dodged from paying it doesn't show up in their estate. There would be some loss of revenue at the end of the road but when you consider that it is only 70-odd million a year that we are getting out of the tax in terms of the $6 billion dollar budget it is pretty small.

THE CHAIRMAN: Is that a fair measurement? In terms of what you are going to replace it with it doesn't look so small, when you start looking around for other sources.

DR. PETRIE: No, that is right. This is a

field of taxes which was the right exclusively of the provinces all during peace until 1941 when the Federal Government got into it as a wartime measure, and Mr. Illsley gave no indication whatsoever in the Budget speech, a part of which I have quoted in the footnote that it would ever be abandoned. He didn't lead anybody to believe it was a temporary measure such as we were lead to believe that the Income War Tax Act was a temporary measure.

I don't like the principle of having to impose an extra-special tax to reinforce the administration of another tax. Surely if the administration of the income tax can't do their job they ought to give up. Why do we have to go through all this nonsense? I feel strongly in favour of the Provinces in this particular case. This is one of the old, old taxes that they had and I think it should be left with them.

THE CHAIRMAN: Thank you. That is all I have on estate taxes. Does anybody else want to ask any questions?

COMMISSIONER GRANT: Just one: if the estate tax is to be administered by the provinces and the Federal Government does withdraw, Dr. Petrie, have you given any thought as to the desirability of uniformity of legislation as among provinces?

DR. PETRIE: Yes. I would sincerely hope that the ten provinces would get together at the Provincial Treasurer level and the Attorney-General level and try to hammer out uniform pieces of legislation applicable throughout the country, bearing in mind the

legal provision of situs, on which there is a tremendous amount of jurisprudence. This isn't one of the most difficult problems which confronts my proposal. This I think is within the realm of possiblity, joint co-operative treatment of the problem. I think it could be done.

The only problem arises out of the constitution in Quebec which is not a common law Province and the whole subject of estate and relationships is different from the other nine provinces, but still I think it could be worked out.

COMMISSIONER GRANT: If it were uniform within the nine common law provinces it would be a feasible thing?

DR. PETRIE: I think so, yes. That is my considered view. I think it could be worked.

COMMISSIONER GRANT: The rates could vary.

DR. PETRIE: The rates could vary, but I think the base of tax could be pretty well uniform.

COMMISSIONER GRANT: Now, in the absence of uniformity of legislation or anything approaching uniformity you would recognize that with all ten provinces in the estate tax field or succession duty which is there -- that this could add considerably to the burden of estate administration cost.

DR. PETRIE: Yes. We had that through the war.

COMMISSIONER GRANT: Yes, but from the point of view of estate administration I have met with the suggestion that the Federal Government would

enter the field and the provinces withdraw and thus cut down on the cost of estate administration considerably.

DR. PETRIE: I agree with that but my premise here is that I believe it could be worked out at the provincial level. I cannot see any political leaders in the provinces really throwing roadblocks up in any way at a constructive measure like this. I would be one of the first people to persuade them to act like normal human beings.

COMMISSIONER GRANT: Insofar as the total take is concerned it is considerably less costly to have it administered by one Governmental authority than it would be by ten.

DR. PETRIE: This gives us centralization of all things in the hands of the Federal authority. This is no longer the political philosophy.

COMMISSIONER GRANT: Is your suggestion that the Federal Government should withdraw based upon the political elements which come into play?

DR. PETRIE: That is right. I don't know whether I put the words in this particular submission or somewhere else, but I said the breakdown of the Dominion-Provincial tax agreements centralizing these taxes in the hands of the Federal Government was the most retrogressive tax in my memory because when we had them centralized way back in 1941, 1942, then we had uniformity and not all the overlapping and nonsense that went on before the war but you can't live that way any more in this kind of society of ours because provinces wouldn't go for it.

THE CHAIRMAN: That is true, of course taxation is not very useful as an economic tool, is it?

DR. PETRIE: That is right, and this is a very strong point I could make. I am sorry that your colleague, Mr. Perry wasn't here because I had anticipated he would rather question my statement that fiscal policy is a pretty ineffective tool and is more so now you have decentralization because if as a matter of fiscal policy and tax policy the Federal Government decides to cut taxes across the board to stimulate economy what guarantee is there that the provinces wouldn't step in and pick up the whole of the money and the Federal fiscal policy is nullified. Under the best conditions possible the ideal circumstances were back in 1941 and 1942 in the war when the fiscal policy really worked when we had this complete centralization as a wartime emergency situation.

COMMISSIONER GRANT: You favour the principle of strong central Government with the principal taxing power being vested in it?

DR. PETRIE: That is right.

COMMISSIONER GRANT: You favour a rewriting of the B.N.A. Act?

DR. PETRIE: I do, take Section 92 out.

THE CHAIRMAN: I beg your pardon?

DR. PETRIE: Section 92 out tomorrow. I am not facetious, Mr. Chairman, but I know that can't materialize because provincial rights are now more in vogue than they have been in my lifetime but this is

necessary to run Canada effectively, to vulcanize the fiscal structure of the nation. These are my personal statements.

THE CHAIRMAN: Whatever we may think about that is our personal business because it is beyond our job.

DR. PETRIE: That is right. It is outside your job.

THE CHAIRMAN: Supposing we move on to weight of taxation -- is that what it is called -- distribution of the tax burden?

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I observe that you don't come down in favour of proportional income tax. Would your reason for that be because you would not end up with proportional taxation throughout?

DR. PETRIE: That is right.

THE CHAIRMAN: Do you think it would be regressive throughout if you did?

DR. PETRIE: I would think so.

THE CHAIRMAN: You would not favour regressive taxation?

DR. PETRIE: No more regressive than we can possibly have. This again is a matter of degree.

THE CHAIRMAN: It would be interesting to know to what extent it would be regressive, that proportional taxation, wouldn't it?

DR. PETRIE: It would be interesting, and it would be a very difficult exercise, Mr. Chairman, to try to do this measurment.

THE CHAIRMAN: These gentlemen who have recommended this, I don't think they have given any indication as to what the result would be.

DR. PETRIE: Some of the gentlemen who have recommended it, I have discussed the problem with, and I came away quite satisfied that they had not really got into the heart of it, to the extent of regressiveness. It sounds like a fine thing to have proportional taxation but it's too simple. One has an instinct to back away from its utter simplicity.

THE CHAIRMAN: Anything more on that? If not, I am into capital gains.

DR. PETRIE: If I may, before we get into there, Mr. Chairman, just for the record, and I am certain you have realized this, but I think it should be pointed out that my figures, in terms of proportion of the total tax burden borne by direct taxes, versus indirect taxes, is really askew from all the published figures that I have ever seen, anyway.

THE CHAIRMAN: I observed that.

DR. PETRIE: And there is a reason, and it is rationalized in the footnote, that my definition of indirect is different from D.B.S.

THE CHAIRMAN: Could you put your finger on the footnote? I would like to see that again. I observed the different figures.

DR. PETRIE: It must be early on. I can give it to you pretty well from memory.

THE CHAIRMAN: It is because you put what is sometimes referred to as capital tax with direct taxes. Am I right?

DR. PETRIE: Yes, that is right. You will find direct and indirect taxes in the overall tax structure on page 34, paragraph 43, table 10.

Now in all of the published figures, and all of the figures of the Canadian Tax Journal and in any letters, you see that direct taxes are much lower in terms of the proportion of the total. It's because the D.B.S. and National Accounts count as direct taxes only the corporate profits tax, not other corporate taxes, personal income taxes, withholding taxes and death duties. Now I don't believe that this is an

accurate definition of what is a direct tax.

COMMISSIONER WALLS: Are you including, in your own thought, all forms of Governments within the country?

DR. PETRIE: Yes.

THE CHAIRMAN: He puts that, direct taxes with Provincial and Municipal taxes.

DR. PETRIE: They are all direct under Section 92.

COMMISSIONER WALLS: I notice that Professor Milton Moore in his book included property taxes as an indirect tax.

DR.PETRIE: I don't understand this.

COMMISSIONER WALLS: No. I just wondered if you could explain why.

DR. PETRIE: I know the taxes I pay on my house are not shifted to anybody else. I pay them.

THE CHAIRMAN: The only interest in it I see is comparison with other countries and I think you are out of step with the general comparisons.

DR. PETRIE: I say that we are more dependent on direct taxes.

THE CHAIRMAN: Don't most people classify direct and indirect differently from you?

DR. PETRIE: Yes, that is right but not all foreign countries. There is no uniformity. I just want, for our purposes to say, well look gentlemen, direct taxes are defined by John Stewart Milne and adopted by the Judiciary Committee of the Privy Council, and I have accepted his juridical definition and I have said

that Section 92 of the Act confines to Provinces, in a political subdivision, the direct taxation within the Provinces. Just throw them under the heading of direct.

THE CHAIRMAN: Youhave got a good basis on which to tie it in anyway.

DR. PETRIE: In that chamber I have; I would be unassailable.

THE CHAIRMAN: I noticed then on page 85 you say:

"In European countries capital gains
"are treated typically as ordinary income
"for tax purposes under a variety of relieving
"measures and specific exclusions of some
"types of gains."

I know in European countries this applies to businesses but most frequently this does not apply to individuals; applies to businesses?

DR. PETRIE: Businesses, yes.

THE CHAIRMAN: Most European countries are inclined to not tax capital gains but to tax speculative profits and to draw a distinction between the two. A proportion use a time measure, or something of that kind, to pick up speculative profits and in the United Kingdom they don't tax capital gains. They declare a tax -- the President of the Exchequer Court said he would not use the measure of taxing capital gains. I just wanted to point out it is not very broad. One of the few countries who taxes capital gains throughout is the United States.

Now you come to some conclusion under the

heading "capital gains" and that is that you would apply a measure to the taxation of property transactions.

DR. PETRIE: Exclusive of residential property.

COMMISSIONER WALLS: Could I ask a question there? When you say exclusive of residential property, under what classification would you place a farm?

DR. PETRIE: If it is occupied by the owner?

COMMISSIONER WALLS: If it has a building, a house on it then you would exclude farm land?

DR. PETRIE: That is right.

THE CHAIRMAN: In Saskatchewan where the farmer lives inthe town and has what amounts to a farm factory, I suppose, and he sold his land, you would tax him?

DR. PETRIE: I think so. Used for residential purposes is what is meant. In other words, I would be happy -- I wouldn't say I would be happy, but I would be prepared to be taxed if I were a speculator in residential property. I did not live in the residence. By excluding residential properties used as a residence, I don't want people behind the eight ball who have happened to be moved by their corporation from one town to another, Montreal-Toronto, and vice versa and know if they live in the house and use it for a house, and have to sell it, because they are transferred from one office to another, and make a capital profit of $10,000, they should not have to pay taxes. It is beyond their control. If I am speculating in this sort of thing, I think I should be taxed.

THE CHAIRMAN: You wouldn't worry about these

people who speculate in their own homes? Who live in a house for two or three years and do it over and sell it?

DR. PETRIE: To catch those people is administratively impossible.

COMMISSIONER WALLS: The only thing that strikes me is you only mention a quick turnover in real estate. You are not including the much faster turnover in equities?

DR. PETRIE: My basic approach, Mr. Walls, is simply that we should have a capital gains tax, as such, in Canada.

THE CHAIRMAN: I wish you would keep on and define what you mean by a capital gains tax.

DR. PETRIE: Well again this is a gain from the purchase and sale of property, any type of property, real or personal, moveable or immoveable. I don't think this should be singled out for special taxation. Neither do I think that in ordinary cases, should it be brought into the concept of taxable income, as it sometimes has been, but in order to clarify real estate, it's one of the really bugbears, as I see it, in this present problem in a capital gains income versus taxable income. I would like to see the Act amended as far as I have gone to see those classifications of real estate clearly in as capital gains, to be included in taxable income but I don't think we should tax the profits that a person might make and allow the losses that he may incur in equity transactions. Not at all.

THE CHAIRMAN: Dr. Petrie what concerns me a great deal is you come to that conclusion because, I suspect, there are people who virtually live off security transactions; who spend a great deal of time indeed sitting in the brokerage office and giving orders to buy and sell and don't pay taxes. And then I think there are people who do not quite get into this category, who are partially in the office and partially doing something else, perhaps a chartered accountant, who again supplement their income, and to a very large extent, with these kinds of gains. For the life of me I find it very hard to see why they should not be taxed.

DR. PETRIE: Well if you want to tax them,
2 then you have to allow the losses, surely in equity. Once you get into this, you get into the real complications that our American friend across the border got into. These are dandies.

THE CHAIRMAN: I don't think I am talking about that. I was trying to make the very clear distinction between those people who actually go into this as a business, and make a living at it, as part of their business, because you can be in more than one business.

DR. PETRIE: This is right.

THE CHAIRMAN: But the people who are in the business ---

DR. PETRIE: Mr. Chairman, I know of at least one gentleman who sits in a broker's boardroom five days a week from the opening of the bell until closing. He makes a very good living from it. I think he should be taxed because I regard him as a professional trader.

The people who own the company where he sits are brokers and they pay taxes because they are a professional, but they are no more professional than he is but as a consultant who has a fling in the market here and there and I take my losses and I have my gains, if I am lucky, I don't think that I should be taxed on these.

THE CHAIRMAN: We have got three categories there: the professional, the sort of semi-pro I suppose, and the man who is not a professional at all, doing something else.

DR. PETRIE: That is right.

THE CHAIRMAN: Category two, you think he should be taxed.

DR.PETRIE: This is the whole borderline area. The men who are devoting, presumably full-time, to running some sort of business that has nothing to do with the trading of securities but who, nevertheless, do a lot of trading. I don't know whether you classify them as pros or not. I would let them alone, for administrative reasons if for no other. I can also argue that there are other good reasons to let these people alone. We are trying to develop equity markets in this country; trying to broaden equity markets, where more equities are available to the public. This is the unofficial ennunciated Federal policy, and then the minute we start imposing special taxes, or bringing them into the concept of a company, I think we create all sorts of difficulties.

THE CHAIRMAN: Aren't you asking for these

to come into the taxation of capital gains?

DR. PETRIE: I try to keep away from it.

THE CHAIRMAN: You are trying to keep it down.

DR. PETRIE: The taxable income. I have no quarrel with the interpretation of the concept of taxation income as presently pursued by the Department of National Revenue.

THE CHAIRMAN: And your category No. 2, the man who sits in a brokerage office, should be taxed?

DR. PETRIE: That is right.

THE CHAIRMAN: Just as the real estate agent people are taxed under it?

DR. PETRIE: That is right. And there is no problem in catching up with this man. I am surprised my friend in Montreal on St. James hasn't been caught years ago. All I have to do is do a snap audit of this particular company's ledgers and it will show his ins and outs all day long; show how much money a year he is making. I think they should tax him.

THE CHAIRMAN: I raised this particularly, I am not being concerned about the revenue implications, because I don't think there are enough people in that category, but I think we must all be concerned about the fact that there are people bearing additional taxes and people bearing no taxes. It seems to me that is going to put our tax system in ill-repute with an awful lot of people.

DR. PETRIE: As I say sir, my argument is based on equity and I think that the professional trader

should bear additional income tax, not capital gains taxes, on his income derived from the pursuit of a trade. That is what it is. It's an occupation, as far as these fellows are concerned. It's an adventure in the nature of trade, whatever you want to call it.

THE CHAIRMAN: I would imagine there are quite a few people in the category who are sort of on the fringe and under the present definition in the law, the present law, are escaping taxes?

DR. PETRIE: That is right. There are many of them.

THE CHAIRMAN: You think there are many?

DR. PETRIE: I think there are many. This is the result of my experience as a broker for some five years in Montreal.

THE CHAIRMAN: I am taking advantage of your experience as a broker. I feel you would know as much as anybody would about this particular area and understanding the law at the same time, I feel you are particularly helpful to us.

DR. PETRIE: For many years, Mr. Chairman, I was quite upset to see certain clients of my company, who made very large profits in the great bull market of the '50's, and paid no taxes whatsoever. I think this is completely destructive of the concept of equity behind our tax structure. I have said this on many occasions and the Revenue Department has never seen fit, apparently, to do anything about these people, these particular professional operators, and they are professional operators and I do not think there is any

real administrative problem connected with the real pros.

As I say, they can go into our place and open our books at any time. That is provided for in the law of the land and it would have been as clear as crystal to them, $50,000, $60,000, $100,000 net profit after brokerage, certain clients, per annum. Why should they be tax-free? They shouldn't be, in my view.

THE CHAIRMAN: I am very much concerned about people like that escaping taxes; it might cause the country to make a bad judgment in the area of other matters, with the thought in mind to achieve the equity but it may go beyond that. In order to achieve equity, you may push us in the wrong direction.

DR. PETRIE: It is a worrisome feature of the problem.

COMMISSIONER GRANT: You know the Scripture says the rain falls upon the just and unjust alike and it is pretty hard to say when a man is a professional trader when you get down here. You can certainly isolate the odd person, the man that sits in the boardroom all day long, as you say. The chances are he is in the nature of a professional person.

DR. PETRIE: He is a trader.

COMMISSIONER GRANT: It is very difficult to know where the line is going to be drawn.

DR. PETRIE: It is extremely difficult. Now again my personal interjection: when I was on the street, I paid Federal Income tax on my capital appreciation realized on equity because I was a professional.

I have not paid since I walked away from the investment community because I am no longer a professional. I trade the market often, and have been fortunate in making some profits. I do not report them as income, and I think that the courts would probably, if I were assessed, back-assessed, I have reasonable confidence I would win my appeal, because I am just one of hundreds of thousands of Canadians who dabble in the market.

THE CHAIRMAN: Do you think with greater certainty, and perhaps better administration, there should be something analogous to the time limits that you suggest for real estate, applied to securities?

DR. PETRIE: I think so. I didn't carry this thing out to its logical conclusion, but I would ask a time -- I think it would be wrong to tax as income the profits on a security that perhaps a person bought early in his life and kept for 20 years and it appreciated, any more than it would be reasonable or equitable to tax the sale of his home, after he had lived in it for 20 years and his family had grown up and he had moved to an apartment because he no longer needed a big house -- there are many many people in this country who have owned some equities for years. Their capital appreciation has been very substantial, partly as a result of price inflation. I am not interested in making those people bear income tax on that capital appreciation.

THE CHAIRMAN: A measure of, say, one year?

DR. PETRIE: One year or two years perhaps. If a person is in and out of the market, say, even for two years I think he is a speculator at heart. It is difficult to define.

THE CHAIRMAN: It is difficult, and of course, it would never be wholly fair.

DR. PETRIE: No.

THE CHAIRMAN: It is difficult to know whether, with certainty, it is of sufficient value to set off against the unfairness which would result from people having to pay taxes who normally should not be. Is it fair to catch people who shouldn't be?

COMMISSIONER GRANT: I just want to make one observation on the table on page 81, Dr. Petrie, which gives the breakdown between savings and investments. I think that is what I had in mind this morning. There was that difference.

DR. PETRIE: The investment figure is the total of new investment as published by the Department of Trade and Commerce for fixed assets. This is what is being put in place.

THE CHAIRMAN: These are fixed assets, not the purchase of securities?

DR. PETRIE: No.

COMMISSIONER GRANT: These are private and public investments?

DR. PETRIE: Private and public. This means schoolhouses, hospitals, highways, bridges, sewerage systems.

COMMISSIONER GRANT: All capital

investment?

DR. PETRIE: All fixed capital investment.

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COMMISSIONER GRANT: Fixed capital?

DR. PETRIE: That is right, whether it is public, Government or whether it is private which is business. This is the total of the investment, for instance in 1962, new fixed assets estimated at 8.7 billion dollars were put in place in this country and the total savings which includes private and corporate amounted to 6.9 billion. This includes the retained earnings of corporations as well as personal savings, so that we have a short fall of a billion eight. We put in place a billion eight more than we saved generally through our savings structure.

This is why we have to depend upon foreign capital if we are going to keep this rate of expansion.

THE CHAIRMAN: It was indicated to me somewhere that we were generating sufficient capital in Canada for our own requirements. I think that cannot be the case unless one might add the savings depreciation taken by industry.

DR. PETRIE: Yes.

THE CHAIRMAN: And thus get the cash flow which was probably as much as investments, would that be fair, to do that?

DR. PETRIE: It might be. National Savings Account, page 34 of National Accounts, 1962, personal net savings, two billion three, business gross savings undistributed profits, nine hundred and seventy-five million, capital consumption allowance of four billion seven -- this was depreciation.

THE CHAIRMAN: Is that 1962?

DR. PETRIE: It is 1962 so your depreciation is included here so your cash flow, as you like to call it as an accountant is six billion nine and the total investment in new assets was eight billion seven.

THE CHAIRMAN: Could we add the four, seven to the six, nine?

DR. PETRIE: This six, nine -- I will go more slowly and give you this breakdown if you like? Personal savings, two point three billion, Under business saving, undistributed profits nine billion; capital consumption allowance four point seven billion, and then they have some residual adjustments here and they give you a total of six point nine billion, that is total gross savings in the Canadian economy.

THE CHAIRMAN: Now, within total savings you take your business saving of nine plus capital consumption of four point seven.

DR. PETRIE: Add that on.

THE CHAIRMAN: Two point three personal . . .

DR. PETRIE: You add two point three, nine, four point seven and -- this is the way the national accounts are calculated, you deduct Government deficit of seven hundred and seventy million and inventory valuation deduction -- these are planning items.

THE CHAIRMAN: We are getting into areas I think we will leave to the staff.

DR. PETRIE: Your staff will know all about this. This answers your question about the cash flow from capital cost allowance. Then in the totals and we still have a short fall of a billion eight.

THE CHAIRMAN: So we therefore needed seventeen and one half billion dollars in order to pay for our investments and we had to go abroad to get that?

MR. PETRIE: That is right, and the difference between these two columns is basically in flow of new capital from abroad.

THE CHAIRMAN: Now, coming back to the conclusions on page 92 you advocate the deletion of any reference to adventure or concern in the nature of trade. If you did the consequence might be that you would narrow the definition of income as we know it at the present time and some of these quasi capital transactions might then not become taxable, I would presume?

DR. PETRIE: This might happen. My objection to the adventure in the nature of trade is that it is such an ombinus class that anything you think of might be deemed by the judiciary to be an adventure in the nature of trade, almost anything.

THE CHAIRMAN: Hasn't it been thus decided in real estate transactions?

DR. PETRIE: Yes.

THE CHAIRMAN: You suggest that the law has gone too far in that respect.

DR. PETRIE: I think so.

THE CHAIRMAN: You surprise me. I didn't think that. You may be right.

DR. PETRIE: There have been isolated cases where a single profit in a transaction, an isolated one has been called a taxable income. One of the best

cases is an old one where an Englishman who never having been in the textile business bought post-World War I linen from France at a sacrifice and sold at a profit in the United Kingdom. He was never in the textile business before or since. Inland revenue protested and it was held as taxable income by the judiciary.

This is an isolated transaction. This isolated transaction was brought in as an adventure in the nature of trade. This was a fling. If you are going to tax that you should tax me if I buy Chrysler Corporation and hope it will go up 10, 20, 40 points.

THE CHAIRMAN: I guess they perhaps should. I think the linen fellow should have been taxed. I can't tell you exactly why I think that. Are there any tax incentives which you would throw out?

DR. PETRIE: Barring the depreciation allowance on wasting asset industries which may properly be called tax incentives, I don't know, but barring those I can hardly think of any incentive that I wouldn't throw out. I don't like tax holidays. I don't like accelerated depreciation. I don't like exemptions of companies who are competing with fully taxable companies such as credit unions. These are the main incentives I would like to get rid of. Probably the more irksome incentive of all, as I view it now is the withholding tax as presently proposed, 10 per cent and 20 per cent withholding in accordance with the ownership of the company. I think this is egregious.

THE CHAIRMAN: More vigorous enforcement of tax laws is almost your final recommendation.

Are you conscious that the tax laws are not being vigorously enforced?

DR. PETRIE: I don't think they have been as vigorously enforced as they might have been. There has been great and widespread public belief that certain groups of taxpayers effectively dodge their tax responsibilities. Whether this is true is not the point. Psychologically if the mass of the people who pay full taxes because of payroll deductions think that they have a real cause for embitterment. There is no doubt certain taxpayers have been successful in evading taxes. The prosecutions have borne that out. Whether Revenue has the manpower really to police I don't know. Certainly this has been called to your attention very vigorously I see in reading of my newspapers, the Globe and Mail and so on regarding certain deductions of taxes down in Quebec for so-called charitable gifts. I have quoted a few figures and one court case. This is the sort of thing that destroys taxpayer morale or if it doesn't destroy it it certainly damages it.

If a man is honestly paying his full burden and if he feels his fellow man is not paying his full burden that is bad for the morale of taxpayers. This is one of my strong recommendations that there should be the tightest possible enforcement. The present Minister of Finance paid attention to this in the 1963 Budget speech last June 13th when he said he was directing the Department of National Revenue to tighten up on certain of these matters, stripping of dividends -- there are so many gadgets and gimmicks

in this complicated mass of tax laws that some of us make a good living out of it because we are employed as so-called specialists in the field and you can find loopholes in the Act and you run your jeep through the loophole. This is wrong. It is basically wrong.

If we had a simple Income Tax Act it would be much easier to enforce.

THE CHAIRMAN: Can you conceive of a simple Act which would be equitable. You can answer that by saying I conceive of one more simpler. That isn't
2 quite the question I am asking you.

DR. PETRIE: I know. Probably if you make it a simple Act, still trying to tax the things you are trying to tax then it becomes inequitable. If you had complete elimination of the double taxation of corporate income and dividends you could take several Sections out of the Act. Supposing for the sake of argument that dividends were taxable the same as bond interest, you could have a simpler Act, I think.

THE CHAIRMAN: I am not a bit sure that if I agreed with that it wouldn't only be because of ignorance because I haven't seen it done and a lot of things look simpler than they are until you get at them and they become extremely complex.

DR. PETRIE: I realize this, and of course we are confronted here with the complexities of the Act that have been established as a result of bright people finding loopholes in the Act and then administration having to close this door, and as they close this door somebody finds another hole and they keep on closing

them unless you get a super-complicated tax structure over the years. The original Act was quite simple.

THE CHAIRMAN: I think that is all we have got, Dr. Petrie. I am extremely grateful to you for giving us a most interesting time.

DR. PETRIE: Thank you. I had hoped you would ask something about withholding taxes.

THE CHAIRMAN: I have read your points on withholding tax. I understand them very well, I think. If you would like to volunteer something on withholding tax we would be glad to put it in the record. It is, of course, in the record here.

DR. PETRIE: If I may, sir, there are a couple of executive officers of distilling companies who are directly concerned. Mr. Cox is one. His company is vitally concerned with this. I would rather have somebody speaking directly from the flight deck of the company operation than I speak as just an observer looking from the outside. Mr. Underwood represents the opposite extreme. He represents a wholly-owned subsidiary of a U.K. company. Mr. Cox represents a Canadian company which has a wholly-owned American subsidiary. If you could give us a few minutes I assure you this gentlemen could give you some information.

THE CHAIRMAN: It would be most interesting to us if they disagreed. We would like to hear them disagree.

MR. COX: Briefly I could give you our problem. We are a Canadian company that started in a

small way and at the time of repeal we went into the United States and became rather a complex and huge organization. Today ......

THE CHAIRMAN: You are Distillers Corporation, Seagrams.

MR. COX: Distillers for Seagrams. Today our balance sheet is quoting $600 millions. Our profits are in the $30 or $40 million group. We are a Canadian company that has developed in foreign countries, mostly in the United States. Our sales are less than 10 per cent to Canadians. Our profits can be said to be much less than 10 per cent from Canadian operations and we are a company with a Canadian parent and Canadian-controlled and the bulk of our shareholders are Canadians, by and large the majority. We are in the unfortunate position now that in order to meet our dividends, we are bringing up -- meet our dividend requirements it means we have to bring inter-company dividends from our subsidiary up to our parent.

As soon as we do that, since Mr. Fleming's Budget a couple of years ago, it was almost five per cent -- it was five per cent and we could live with that. This five per cent isn't -- there is no offset because the dividends coming up are more than 25 per cent controlled and therefore dividends are free, but the 25 per cent withholding was withheld in the United States which was an extra tax. That amounted in our particular case maybe to anywhere from half a million to a million dollars a year extra taxes that we were paying, but we could live within that. Once it

was raised to fifteen per cent it became a little prohibitive in order to finance any capital outlay we want to make in foreign countries, and in addition to that to meet our dividend requirements. We pay our dividends in Canadian dollars and therefore we are now in the position of looking elsewhere rather than bringing inter-company dividends.

You can do this for a certain length of time, mayb a couple of years, two or three years and sometime you have to face up to it.

Where we stand today since this reciprocal arrangement is anything but clear -- unless there is a change it would seem to me with the reciprocal it will still be 30 per cent because we are in the position that our subsidiaries are 100 per cent Canadian-owned and therefore we would be in the same class as any other individual in the United States that has 30 per cent dividend withholding tax.

If that is the case then the bulk of our profits which are made in the United States, we would be paying at the United States rate of 52 per cent and we would pay 30 per cent however on the divideneds which is 30 per cent of 48 -- we are getting to a dividend rate that is rather astonishing, about 85 per cent. If we are going to maintain that our management would have to face up to the facts, what can we do about it. The only way I can see, and this is only my personal views, we would have to divest ourselves of interests that are outside of Canada into another country because the tax would be prohibitive to carry on a subsidiary

of a Canadian company.

THE CHAIRMAN: Let me see whether I am clear on the 30 per cent. I think I understand it fully: what you are saying is as the situation now stands that there may be no benefits from any treaty whatsoever and that the withholding tax from the United States is 30 per cent save in the case where a treaty applies.

MR. COX: That is right.

THE CHAIRMAN: It is the intention, of course, for Canada to renegotiate five per cent to fifteen per cent. This hasn't been done and in the absence of such renegotiation the rate of tax may well be 30 per cent, but you don't know what it is; is that right?

MR. COX: That is right. Even if it is renegotiated on the same basis in Canada where it is a withholding tax of 20 per cent, which is pretty near as bad, but is not quite as bad because we are 100 per cent Canadian-owned, our subsidiaries are 100 per cent Canadian-owned -- if the United States had the same terms in as Canada has . . .

THE CHAIRMAN: They may well pass a law, ask you to sell 25 per cent of the stock in the United States and you will pay 20 per cent. That is what you are thinking of?

MR. COX: That is true, because we think it's the ownership of the subsidiary company,

/RPS

not the ownership of the parent company that applies.

THE CHAIRMAN: Your 65 per cent is really, I suppose, 67 per cent at a 30 per cent rate?

MR. COX: Yes.

THE CHAIRMAN: It's 52 plus half of 30. Let's see the other one.

MR. UNDERWOOD: This comes from an entirely opposite concept and I would have to speak from the point of view of our parent company. Our company in Canada, the Canadian incorporation has been built up entirely of British investment and retained earnings here.

THE CHAIRMAN: What is your company sir?

MR. UNDERWOOD: W. & A. Gilbey (Canada) Limited. The British Inland Revenue has been encouraging our parent company to leave earnings overseas by declaring us an overseas trading corporation, and earnings have been left here.

Now we cannot take out the earnings that have been left here, by virtue of the dividend stripping legislation as in the past and if the 20 per cent tax applicable in January 1st 1965 is not offset against U.K. taxation by an amendment to the U.K.-Canadian tax agreement, then it is going to give a rate of tax of around 63 per cent on Canadian earnings by the time it has arrived in the hands of the parent company.

THE CHAIRMAN: You are not suggesting that the increase to 20 per cent is a restrictive increase because you did not distribute your earnings? You

always had the right to distribute earnings, but you elected not to do so.

MR. UNDERWOOD: Yes. The British company was encouraging British corporations to leave their earnings abroad.

THE CHAIRMAN: You say 20 per cent withholding will cause the total to be about 63 per cent?

MR. UNDERWOOD: Yes, if it cannot be offset.

THE CHAIRMAN: Even if you did have it offset, it would only be offset to the extent of the U.K. tax. You would still have the higher of the two and the higher of the two would be 63 per cent?

MR. UNDERWOOD: As we are one hundred per cent owned, they get complete offset on Canadian taxes at the moment.

THE CHAIRMAN: Their rate won't be as high as 63 per cent in the U.K.?

MR. UNDERWOOD: No, they won't be.

THE CHAIRMAN: So you still suffer 63 per cent taxation on the Canadian company?

MR. UNDERWOOD: Yes. 53 per cent at the moment I think.

THE CHAIRMAN: Yes, because there is no withholding tax.

MR. UNDERWOOD: No.

THE CHAIRMAN: With deepest sympathies, we will stop there. Thank you very much. We are glad to have all this information and this has been a most helpful day. Dr. Petrie, you are going to now have a little chat with our people, I understand. That is

very good of you. We have nothing more up here, except to say thank you very much.

DR. PETRIE: Thank you sir.

THE CHAIRMAN: We stand over until 9:30 Monday morning.

---WHEREUPON THE HEARING ADJOURNED UNTIL 9:30 A.M.,
MONDAY, THE 4th DAY OF NOVEMBER,
1963.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT
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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Monday, November 4th, 1963.

C O M M I S S I O N :

MR. KENNETH LeM. CARTER -- Chairman

MR. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

MRS. S.M. MILNE

MR. CHARLES WALLS

LEGAL ADVISER:

MR. J. L. STEWART, Q.C.

RESEARCH DIRECTOR:

PROF. D.G. HARTLE

SECRETARY:

MR. G.L. BENNETT

* * * * *

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* * * * *

---ON COMMENCING AT 9:30 A.M.

THE CHAIRMAN: Mr. Secretary, I think it is now 9:30. We might proceed.

THE SECRETARY: Thank you. Mr. Chairman, Commissioners, this morning we have a brief being submitted by the Atlantic Provinces Economic Council. This brief was received in our office on October 16th and is before you. To speak to the brief this morning are four officers of the Council. Mr. J.S. Wright is President. Mr. Wright is General Manager of the Amalgamated Dairies of Summerside P.E.I. and with him, Mr. Nelson Mann, Executive Vice-President. Mr. Arthur C. Parks, Director of Research and Mr. F.T. Walton, Economist.

Mr. Chairman, I would like to enter this brief into the record as Exhibit 242.

---EXHIBIT NO. 242: Submission of the Atlantic Provinces Economic Council.

SUBMISSION OF

THE ATLANTIC PROVINCES ECONOMIC COUNCIL

Appearances: Mr. Nelson Mann Mr. Arthur C. Parks
Mr. John S. Wright Mr. Frank T. Walton

THE CHAIRMAN: Good morning Mr. Wright, gentlemen. We are indeed glad to have you today with us. We are grateful for what you have sent to us, and

we have read it with considerable interest and certainly we will have a few questions to ask you with regard to this submission.

Would you tell us, Mr. Wright, before we get to the substance of this, a little bit about your organization. Mr. Grant referred to it as A.P.E.C., and perhaps we could use that. It seems pretty descriptive or seems a neat way of referring to it. I observe that you have a number of members from various backgrounds, and so on, and anything you care to add to this we would be very glad to hear, with particular reference to just how you prepared such a brief as this one.

MR. WRIGHT: Thank you Mr. Chairman.

THE CHAIRMAN: You can stand or not as you please.

MR. WRIGHT: I think probably I had better stand sir.

Mr. Chairman, and members of the Royal Commission, before proceeding with our submission I wish to express our appreciation for this opportunity of presenting to it you. In line with your suggestions sir, we have some facts here in connection with our organization.

I believe Mr. Nelson Mann, our Executive Vice-President, can supplement what I have to say in greater detail.

The Atlantic Provinces Economic Council is an independent, non-political, non-Governmental organization formed in 1954. It is dedicated to the objective of accelerated economic development in the Atlantic

Provinces of Canada. It conducts research into economic matters and recommends appropriate action to both Government and industry.

The Council derives its income mainly from membership contributions by industry, commerce, other organizations and private individuals, and from research studies commissioned by public or private groups or individuals.

It will be appreciated that the matters coming within the concern of the Royal Commission on Taxation are of great interest to the Atlantic Provinces Economic Council.

I am sure you are now aware, or will be aware when Mr. Mann has elaborated more fully on this sir, the aims and objectives of the Atlantic Provinces Economic Council and that the organization is in very close touch with the situation in our four Provinces.

We are very conscious of the fact that our economy has lagged behind other parts of Canada, and I feel sure it is generally recognized that special measures are essential for the stimulation of industrial development.

We sincerely hope that our representations are put forward in such a way as to enable you to fully-appreciate the special problem that confronts us in our four Provinces. I would be pleased if, with your permission sir, I may call on Mr. Mann to give you further details of our organization, and such things.

THE CHAIRMAN: Please do Mr. Wright.

MR. MANN: Mr. Carter, and members of the Commission, I only want to say hello again, having met you in Halifax when you were down in Mr. Grant's home.

I would like to deal particularly with the point that you raise in connection with how we prepared this report, because I think we are all familiar with the aims of A.P.E.C. and we are dedicated to the improvement of the relative level of the economy of the Atlantic region with respect to Canada.

When the Commission was established, and word came to us you wanted to hear from us, we wanted to have something to say to you, and so in our Research Section, which is in Fredericton under the direction of Mr. Arthur Parks, we set to work and gathered together a lot of this background information which we provided you, and it cost us a lot of money to do this and took a lot of time, but we think that this is such an important Commission and has such important implications to the future of the Canadian Nation, that we felt that this was the least that we could do to get into this kind of thing, so when we decided the type of thing that we would present, we met with our Executive and we gave them a brief outline at the Executive meeting and we said "How do you like this?" And they said "We like this quite well but we would like to check it with some individuals before it goes out officially", and so we had a meeting with a number of people that were selected by the Executive to sit down and assess this and so we do not come to you with the ideas of only the Economic Section, and as I was saying

last night about Mr. Erhardt , in Germany this is the way he came up but we want you to know that this has been discussed by business people, and we think that in a broad view that this presentation represents the feelings, the general feelings of the Atlantic Provinces business people.

I think that is all I am going to say. Thank you.

THE CHAIRMAN: Thank you Mr. Mann. Do I understand that your organization is one with a staff? I take it you are a member of the organization. You are Executive Vice-President of it?

MR. MANN: Well we have a staff of 15. When we started in 1955, this was when I was hired, first we had a staff of two, and we went on from there to five, ten, fifteen. Four of those are in Fredericton, eleven of them are in Halifax. The Fredericton Office is going to expand its research facilities because of the great demands made upon us for information of this kind, through a policy of development, where people have moved out of the wondering section and say "How is A.P.E.C. getting along?" "What are you doing?" "Is it worthwhile?" "Are your ideas sound?" And we have come through and we have been accepted.

The Atlantic Development Board is something which we suggested. A.R.D.A. is a very active organization at the Federal level in the Atlantic Provinces and now the Area Development Agency and the Department of Industry is going to move into specific things across Canada on industrial development. These three, for

example, Federal Agencies are going to want special information and we are going to provide a lot of it, so we have to expand our research facilities.

On the other side, to maintain the private sector and the private side of A.P.E.C., we do the promotion work for the Halifax Office, such as goes into St. John's, and the rest of Newfoundland and it goes to P.E.I., New Brunswick, Nova Scotia.

We have special Committees within the Council, comprising business people and these Committess consist of Federal products, Industrial Electric Power and then we have two sort of standard Committees in support of us, our Financial Committee and our Membership and Public Relations, so we have five main Committees, three of them out in the field working for the improvement of the region. Then we have our research group in Fredericton which we are going to add to.

This, basically, is our setup. Now we have a budget in the neighbourhood, this year, of $120 thousand. Some of this goes for salaries. Considerable of it goes for travelling and we get most of our funds from private industry, central organizations; that is organizations whose head office is in the central part of Canada and have branch offices in the region, support us but much of our support comes from business in our region.

This is an unique organization in Canada. There is nothing else like it. In Ontario you have a similar organization completely sponsored by the

Government. This same thing is true in Manitoba and Alberta and Saskatchewan and British Columbia, but because of the four separate Provinces, and the regional concept here, it is not too easy to bring together the Governments of those four Provinces, perhaps with different political faiths, and put them together like A.P.E.C. has done; on the business level bringing together the Governments.

This is because we set up, in addition, the Atlantic Provinces Research Board. This was intended to be a liaison between ourselves and the Government and economic research. It has worked very well. The Government finance this Board; have put members on it and have invited A.P.E.C. and the Maritime Transportation Commission to sit on it and so we have a liaison body with the Governments which works very well.

Thinking over the years, and thinking back it will soon be ten years in operation, our effectiveness has grown every year and I think has been of real value to the region and to Canada.

THE CHAIRMAN: Now you have your own research staff located in Fredericton I think you said and Mr. Parks is the Director of Research and you apparently carry out studies which you are commissioned to do. Does that mean various industries would take themselves to you and say "Would you please conduct an examination of the Atlantic Provinces to see what areas are suitable for the increase of this industry" or those sort of things?

MR. MANN: This has not been generally the

type of research which we have done. We have, in the early stages, attempted to establish what the regional economy was made up of, how it was made up, and relate this to the rest of Canada.

THE CHAIRMAN: But you will do commission work?

MR. MANN: Yes, commission work is work that is on assignment from the Atlantic Provinces Research Board. Something that would cover the whole four Provinces. It may be from the Atlantic Development Board. Now it could be from industry. We would not not do it, but industry has to have the initiative there and to make the suggestion, and in the case of industry in a Province, it is more likely to go to the Government of that Province and say "Will you help us?" such as that which resulted in the establishment of industry, and things like that, in Nova Scotia. Now New Brunswick has a similar organization.

THE CHAIRMAN: You indicated that you had gone to considerable expense in this brief. Does that mean you went beyond your own staff in the preparation of this? I can understand even if you didn't, of course it cost you quite a bit of money.

MR. MANN: Yes, we did. We won't say it cost us money. It cost somebody money. We went beyond our staff to do this, and we spent considerable time doing it.

THE CHAIRMAN: Thank you. Before we commence questioning, is there anything you gentlemen wish to say by way of amplification or summary of a general

submission which you have made, which commences in section one on page one?

MR. MANN: We would like, Mr. Chairman, to have Mr. Arthur Parks, who prepared this, be our spokesman, generally speaking, in reply to questions.

We are all here to help out wherever we can. As Mr. Grant informed me, he said well now if you would like to, you know, we can say what we have to say whenever you feel like it. Mr. Parks is our spokesman so Mr. Parks, would you like to deal with this?

THE CHAIRMAN: Mr. Parks, we would be very glad if you would.

MR. PARKS: Yes, Mr. Chairman. Members of the Royal Commission, I think probably something of what you request is provided in a summary. We did try to prepare a summary of the submission and make it as brief and as concise as possible.

The first section of the submissions are concerned with the discussion of the economy of the region in general, and in some of its more particular aspects, all leading up, of course, to the recommendations which are contained in the last part of the submission, and also included in the summary.

Generally, of course, these submissions deal, as a principle of tax incentive, as an aid to economic development. I should like to point out sir that we do stress the point that, of course, incentives by themselves, without other development policies, are not likely to be very effective as an instrument for either

national or regional, and particularly economic development.

The recommendations, in general, deal with the types of tax incentives which we feel might have a role to play in encouraging a faster rate of economic development in the Atlantic Region of Canada.

THE CHAIRMAN: Thank you. As a matter of terminology, I would like to clearly understand, or see if my understanding is correct. When you speak about "Maritime Provinces" you are referring to three. When you speak of "Atlantic Provinces" you are referring to four. Am I correct?

MR. WRIGHT: That is right.

MR. PARKS: That is correct sir.

MR. MANN: At this stage though, you cannot get away from the word "Maritime" and we do not think anyone in the Maritimes really wants to. When you bring in the four Province concept, the Atlantic Provinces suit us much better.

THE CHAIRMAN: Now I observed pretty well early on in your submission, and I cannot recall where it was, you acknowledge that there had been fair economic stability in the Maritimes. I think it is really on page 13, paragraph 22 where you point out that a relatively high proportion of employment is in primary occupation, and the result of that is to provide a fair measure of economic stability, more so than the rest of Canada.

Well I suppose if one accepts the virtue of stability, you have got to acknowledge that you cannot

expect to have the same growth rate as between those parts that do not have the same measure of stability. Is that not right?

MR. PARKS: Yes sir. On a matter of stability, if we accept personal income per capita as a measure of economic achievement, and we have to use this because there is no other sort of comprehensive measure available, and you look at personal income per capita data from 1926, when D.B.S. first began to provide, or record this type of information, you will find that the percentage relationship between per capita income in the Maritime Provinces and in Canada remains pretty much the same.

Now there are short term changes. For example, during the depression of the '30's, this percentage relationship tended to rise slightly, which reinforced the observation just made, and this has occurred again in the latter war years, and it has occurred, I think to a slight degree, more in the last few years.

B/RPS

Of course this, I think, is one of the main factors causing this situation, the fact that the economy in the Atlantic Provinces has not industrialized to the same extent that the economy of the central part of the country has industrialized, and as a result we don't get the industrial employment in the Atlantic Provinces which comes along in the other parts of the country. This again is directly related to the relatively high proportion of labour force engaged in primary and self-employed occupations.

THE CHAIRMAN: We measure the economy, I suppose, in several ways, but one of the most important factors I gather from your statement is the proportion of the working force which is engaged, or, inversely, the percentage of unemployment. Now, that leads me to believe if we are directing ourselves to the cure of unemployment in certain parts of the country we should look to the labour intensive rather than the capital intensive industries. I would have thought with the same money spent on textiles, shoes, clothings and so on as would have been spent on say, the oil refineries it would be a much greater advantage in providing employment.

If that is correct, it would seem to me that with incentives subsidies, assistance of other kinds, it should be geared away from capital intensive rather than towards it. Would I not be right, Mr. Parks?

MR. PARKS: Mr.Chairman, we have noted in the submission that it is true capital intensive resources oriented, and export oriented industry, has

in the Atlantic Provinces has gained most substantially, and we have also noted the growth of secondary manufacturing which tends to be more labour intensive has not gained very much and we have said over the last few years that one of the requirements of the economy of the Atlantic Provinces is a fast rate of growth in secondary manufacturing, more labour intensive type of occupations.

Secondary manufacturing, I would suggest though, sir, in dynamic and growing areas of economic activity, possibly not textiles and boots and shoe manufacturing and this type of thing -- an example is the manufacture of light electronic equipment. A firm located in Atholville near Campbellton not so long ago making this type of product and it is a relatively labour intensive type of manufacture. I think we do need this type of industry in the Atlantic Provinces. We have a lot of not only unemployment, but non-productive employed persons also.

THE CHAIRMAN: Then, of course, if that is so and tax incentives -- I am not sure I like the word tax incentives very much, it is a reduction of burden rather than anything more dynamic than that. All taxation can ever be is a burden and reducing the burden away from certain parts of the country and putting it on to other parts, but using incentives, if you like, for what it is worth, it would occur to me that incentives should not be the kind that are most directed to capital intensive industries, and that is where your tax incentives are generally directed to,

as far as they are concerned with capital cost allowance and depreciation. The tax holidays are not so. If that is so would it not be best to devise tax abatement in such a way it doesn't favour one type as against the other type, and the best way to do that, I suppose, would be a tax reduction.

If one wished to favour labour intensive I would suppose that one way it could be done is to actually reduce the allowable rate of depreciation from normal and at the same time reduce the tax rates so that one says if you come in here you will have the least taxes, but it would be not quite as advantageous to the person with the more plant as to with the person with the less plant, the more your capital has been used for employment the better, but why do it the other way around, that seems to me to be wrong.

MR. PARKS: Could I make one observation with regard to a remark you made earlier on, sir?

THE CHAIRMAN: Yes.

MR. PARKS: I think we have to remember with regard to these heavy capital intensive industries that location of this type of plant in an area may set up a chain leading to the development of other industries. There are such things as backward and forward linkages. There are firms which do produce inputs for the main plant and they use outputs of the main plant as raw material. I think when we are looking at the capital intensive, large capital investment things we have to look not only at the employment which is created immediately but at the

additional employment which might be created as a result other perhaps more labour intensive occupations as a result of this particular firm locating in the first place.

THE CHAIRMAN: I would suggest to you that perhaps if one spent $10 million on capital intensive industries as opposed to labour intensive industries the secondary benefit of spreading money around locally wouldn't be as great. Would that not be correct?

MR. PARKS: This is difficult to say, Mr. Chairman. It depends to a great extent on the type of plant, type of product the firm is going to produce, the initial firm is going to produce. Now, it is true and we have made this point that in the pulp and paper industry, for example, you have in the Maritime Provinces backward and forward linkages so maybe capital grants or tax incentives, as you use the term, to this type of enterprise may not have very much effect on employment. If you take some other type of large capital intensive enterprise maybe the secondary results of assisting this particular plant either with capital grants or some other type of incentive may be such that this could be a good investment, this could be a much better investment.

THE CHAIRMAN: I find that difficult to contemplate, but what you say, I am sure, must be correct. In my mind I am contrasting your electronics plant and oil refineries. I would think investments of equal sums of money in the former would give much more employment than the latter.

If that is the case not only would there be more people employed in the community, but these people create what we refer to as downward linkage, creating more economic activity in that area. If I were correct about this, and I am not a good enough economist to have much confidence in my opinions in this area, I would think that the incentives would be very much better directed towards the electronics class than the other.

MR. PARKS: Of course, sir, as I said before this is the type of industry of which we have said over the last few years needs to be directed not only to the Atlantic Provinces but to the Nation. The region particularly needs these new labour intensive secondary manufacturing firms in growing areas of economic activity.

THE CHAIRMAN: From my point of view, people come before us recommending incentives for every conceivable purpose, and incentive is not too difficult a thing for Government to conceive. It is a reduction in taxes and not something that is clearly earmarked. It may be found it does not show up on the National Accounts. I am just doubtful as to what one accomplishes by making tax concessions of these kinds. I suspect that as you have said by themselves they don't do an awful lot, but perhaps coupled with other things they may. I am very uncertain. We will discuss it in the different countries as we go on.

I have asked this question of countries that have used them, generally with not much encouragement,

I am afraid.

MR. WALTON: Mr. Chairman, may I make an observation relative to this particular point?

THE CHAIRMAN: Yes.

MR. WALTON: I think your point, in comparing the immediate employment benefits to be derived by assistance to an oil refinery as compared to, say, a textile plant of some sort is well taken, particularly if you make it a general observation. When, however, you come to apply this to the situation as it exists in the Atlantic Provinces I think it is equally important that you bear in mind the fundamental fact that in the Atlantic Provinces we have a very narrow manufacturing base. I think our total in manufacturing is in the order of 60 to 70 thousand, and of that something like 30 thousand is engaged in so-called secondary manufacturing. The remainder is made up of pulp and paper, fish processing industries and so on.

Insofar as the primary manufacturing industries are concerned they are generally speaking located at the source of raw materials.

Insofar as the secondary manufacturing industries are concerned we have the food processing industries other than fishing which tend to be scattered throughout the region and we have the Dosco group of companies located mainly in one end of Nova Scotia, and a miscellaneous group, another one-third roughly, ten thousand persons employed in a miscellaneous group which does include oil refineries, boots and shoes, sugar refining and so on.

If you look at the urban centres in the Atlantic Provinces these haven't developed as centres of manufacturing activity, generally speaking. If you look at Halifax the activity there is mainly defence service plus port activity.

In Moncton you have the railway employment, distributed type of economic base. The point I am trying to make is what is required here in the context of regional and accelerated economic development for the Atlantic Provinces is a broad thing, is the whole base of the manufacturing industry. I think our concept is that we prefer to have this approached in both ways. It should be given certainly to the kind of industry like textiles and electronics and so on which would provide employment for a short term but it is equally important to have assistance given to additional manufacturing activity, given in such a way as to ensure this will promote additions to the manufacturing base and I think that the fact that in the past our primary manufacturing industries tended to be something based on regional and Provincial means we must ensure this kind of thing goes on as well by approachings things on sort of a broad rather than specific basis in the initial stages of these.

THE CHAIRMAN: Throughout Canada I suppose we have had more difficulty getting secondary industry going at a satisfactory rate than we have primary industry which is satisfying world markets and where there is a need, it takes care of itself.

Secondary industry, looks after Canadian

markets generally, and we have had to direct tariff policy to develop secondary industry, and it seems to me it isn't an easy thing to achieve. In the central part of Canada a lot of attention has been given to the stimulation of secondary industries. I would have thought in your part of the country it might be more difficult to stimulate secondary industry.

MR. WALTON: I think if the stimulation of secondary industry in the Atlantic Provinces is to take place in the context of availability of Canadian markets then this will be extremely difficult. This is one of the encouraging things that happened in the last 18 months, the interest in the export of manufactured goods in this country. I think this is the trend to be encouraged.

I would hope if it is encouraged in this context the Atlantic Provinces will have a better prospect of greater industrialization.

MR. PARKS: May I make one more comment at this time, Mr. Chairman?

THE CHAIRMAN: Yes.

MR. PARKS: I think we do point that out that it is only in the context of a much more rapid rate of growth of the National economy that any substantial improvement can be made in the regional economy.

THE CHAIRMAN: I think you speak about the virtual stagnation of the economy in the last few years. In 1962 it wasn't a stagnant year in Canada. We had a remarkable increase in our growth rate, What happened in the Maritimes? Did you have an equally

good increase in industrial activities? I speak about the G.N.P. being up about 7 per cent.

MR. PARKS: In Canada?

THE CHAIRMAN: In Canada.

MR. PARKS: Yes, in 1962 over 1961 I believe the increase was about 7 per cent and I think that this brought about some increased G.N.P. per capita also. We don't have a comprehensive measure like Gross National Product at the Provincial level. I think we have to use personal income on a per capita basis to indicate this to us. I will ask Mr. Walton to comment on this if I may.

MR. WALTON: First of all with respect to the growth which occurred in 1962 there are two factors here. One factor was the devaluation of the Canadian dollar which has taken place in the beginning of December 1961. It certainly had an effect -- December, 1960, and it had an effect on the comparison of 1962 G.N.P. figures with 1961, and also 1962 was a -- we had a very large grain crop on the Prairies and this shows up to a very significant part in the increase in the G.N.P.

In the Atlantic Provinces in 1961 we did have the largest total amount of new capital investment in the history of the region or at least in the history as data gives it.

A lot of this was associated with the development of the iron ore industry in the Province of Newfoundland. Certainly there are other instances

throughout the region along about this period where new manufacturing activities have decided to locate, or have located in the region.

If you compare the investment picture in 1961, for example, with 1962, there is a substantial growth -- I have forgotten the percentage increase now -- I think it is in the order of 10 per cent but, nevertheless, even after this substantial increase, it will take quite a few years of this kind of thing before we begin to make an impact upon the level of investment per capita and also, if you look at investments spent in the Atlantic Provinces, they tend to have a larger proportion of this coming from public sources rather than private business investment. Private business investment remains very much lower, on a relative per capita basis, than in Canada generally, but I think certainly 1962, to answer your question in general terms, this improvement certainly had found its way into the Atlantic Provinces' economy and had very beneficial effects.

COMMISSIONER WALLS: In your figures where you show that there is a considerable disparity of income between the Atlantic Provinces and the rest of Canada, I was a little disappointed that you did not apply these figures into specific occupations on a basis of cities!. For instance, how does Halifax's average income compare with a City like Regina?

What I am trying to get at is all of the Maritimesare not in a distressed area, so have you any figures that would show, for instance, how the wages of a paperworker

in Nova Scotia or New Brunswick would compare with the same occupation in Quebec or a steel operator elsewhere in Canada?

MR. PARKS: Yes. I might say first this was a matter which was looked at in a special report for the Royal Commission on Canada's economic prospects and the result of this special investigation was that although there is a per capita income differential of one-third between the Atlantic region and the rest of Canada, and probably be larger between the Atlantic region and Ontario, if you look at certain Metropolitan areas, certain urban areas in the Atlantic region and you compare them with urban areas somewhere else in the country, this differential is not nearly as great.

Now, unfortunately, we cannot do this over a period of time. I suppose data are available from the census to go into this type of analysis, but if you want to, we could look at wage rates in, say, the pulp and paper industry and we find that these are pretty even across the country but after all this has been said, and it was studied for the Royal Commission into Canada's economic prospects who point this out also, after this has been studied, the disparity among other people, the disproportionately large number of people employed in such primary occupations as farming, fisheries and logging, the disparity between incomes of these people and those in similar occupations elsewhere in the country is so great that the average level is dragged down and this is one of the main

factors leading to the income differential that does exist.

COMMISSIONER WALLS: I have recognized that, and that was the basis of my next question because if your low average figure is because of the number of farmers, fishermen who have, as I agree, a very small income, but are most of them not comparatively well-satisfied, because having no income to report, they have considerable income in kind? Really, are they as distressed as the income figure would make them out to be?

MR. PARKS: Well insofar as agriculture is concerned, we do have income figures, net income figures for agriculture which do take income in kind into consideration.

MR. WALLS: Of those who have reported.

MR. PARKS: Of those who have reported. With regard to your first question, as to whether these people are satisfied or not, I don't know what the motivation is here. I would suggest that very low incomes are likely to result in a great deal of unhappiness and I don't want to get into the sociological and physiological implications of this, but I tend in my own mind to associate very low incomes, subsistence living, with an unsatisfactory type of existence.

COMMISSIONER WALLS: You admit that all of the Maritimes are not in a distressed situation? You have cities and centres that are doing relatively well compared with the rest of Canada. Now if you give ~~the~~ overall tax easements ~~fto~~ to the Atlantic Provinces,

are you not going to have the new industries that you encourage congregated in the areas that do not need them, rather than in the distressed areas?

MR. PARKS: Yes, but I would like to qualify my answer. First of all, if you get industries congregated in areas which are already enjoying a fairly high level of income, this, I would suggest, is good and although these particular urban areas, where the industry concentration has taken place, in themselves may not need this industrialization, yet the rest of the region does need it and, of course, the point here is that the development in industrial centres in well located, economically located industrial centres should tend to draw unemployed and non-productively employed persons from areas where incomes are very low, to new industrial concentrated areas.

MR. WRIGHT: A very fundamental question in our whole economy in the Maritime is we are losing from our areas some of our best people, because they are not satisfied to continue in the low income that is derived from private industry, such as farming and fishing, and so on. These people, it is our wish that we could retain these people, probably not on the farm. Can't stay on the farm. Can't stay fishing. They would stay within our area.

This, we think, is fundamental in the same way we have got to build up our industries or keep, not only our labour force but the educated young men we are losing to industries outside of our area. This is of extreme importance to us. We must, in some way,

build up our industries where those better types of our people might be employed within our area and not lost to us.

This is perhaps getting a little away from the exact economics of the thing, but it is extremely important to us.

THE CHAIRMAN: I think you are right in accordance with the subject matter. I am curious as to how much migration within your area is taking place, apart from movement out of the area. You don't want people moving out of the area. If the Maritime Provinces succeeded in stimulating their industry, and they got people from Newfoundland, we will say. That is within the area to which you refer. That is within the Atlantic Provinces, would the Newfoundland people not speak about that in the same way you speak about losing people out of the Atlantic Provinces?

MR. WRIGHT: Of course, I think I am right when I say this: that our objectives -- I know I am right as far as our objective is concerned which is to encourage, wherever we can among ourselves, to encourage industry. That is to develop industries in the areas to which they are best suited.

For instance, an industry where raw materials and everything else is available, Newfoundland, that is where we would say that industry should go. The same thing applies for other areas; but I think we have to accept the fact that there is, at the present time, considerable movement from rural to urban.

THE CHAIRMAN: There is throughout Canada.

MR. WRIGHT: Even within our own Province and that is going to continue. I don't think there is anything anybody can do about this but if we can do it within our own areas, and then build ourselves up.

THE CHAIRMAN: Within your own area or areas did you say sir?

MR. WRIGHT: Our own general area. Our own Atlantic Provinces. There is another angle to it that I would just like to speak on, and that is our primary industries. Can we increase our population in our own area so we can have markets for our primary products to a greater percentage?

If Halifax got three times as big as it is now, everybody in that primary industry would be better off rather than having to ship out of the country.

THE CHAIRMAN; Why do you wishto keep people in the Atlantic Provinces? Is this an economic measure, a social measure or is it a social measure just because you like the people you have got there? You speak of the Irish solution somewhere in this submission, and I presume this meant the immigration of the Irishmen at the time of the potato famine. Is that what you meant by the Irish solution? Am I correct in that? I must say I have no idea whether or not this is a good solution for Ireland. I think it has been a very good thing for other parts of the world. Because I happen to have some Irish blood in me, I am a little prejudicedperhaps but I am sure it

is good for Canada. Why is it a good idea to keep the Maritime people in the Maritimes?

I am almost prepared to accept it is, but I would like to know why. What are the reasons for it?

MR. MANN: I have my own views, because people 2 like to stay home. They like to live at home.

THE CHAIRMAN: This is a social reason?

MR. MANN: It is a social reason. If the country was unproductive, and so much unproductive that it could not support them, then there is no reason why they should not leave. When I was growing up, I moved out. I came up here and enjoyed my life here. I always wanted to go back. I don't know particularly why. I just loved it there. That is all. So I went back.

I think that what we are saying, Mr. Walls -- I would like to discuss this briefly. I haven't anything more to say about why people want to stay in the Maritimes. I think it is because this is the sort of thing that should be encouraged in the homeland.

THE CHAIRMAN: Is it economically good or bad?

MR. MANN: It is economically best for the Nation, if you can support them. It is economically better for the Nation, instead of dumping your reserves into some other part of the Nation.

THE CHAIRMAN: We will come back to that after. You carry on.

MR. MANN: Every part of Canada, every Province in Canada, Mr. Walls, has the same problem.

I mean you have your rural people. People outside of the urban centres who are making a lower income than people in the urban centres and, therefore, pull the average down.

What happens in the Atlantic Provinces is that this pulls it down particularly bad, and I am not sure of my figures here but I believe, for example, in Halifax, comparing it with other urban centres in Canada, that it rates on the average something like 12 or 15 per cent lower. I may be quite wrong, but this is what is in my memory.

Now as far as the development of municipal centres, communities, when the West took on its growth, Winnipeg now has over 50 per cent of the total population of Manitoba. There is no such situation in the Atlantic Provinces. You have a number of patches of growth, as far as population is concerned. You have St. John's Newfoundland. You have the Sydneys, surrounding steel and coal. You have Halifax. You have Moncton, Saint John and perhaps now in the Bathurst area which is tending to grow a bit but you have these major centres and there are, as you can see, half a dozen of them. This is quite a lot, and I think that the important thing is to build these centres into areas that have enough secondary manufacture to attract people from the rural areas so that they will earn a higher income and this will be the greatest means by which we can build our total level of income.

Now this is not going to happen overnight. It is going to be a long period of time and many

programmes and policies have to be devised to do this, but it seems to me that this is the way to do it.

MR. WRIGHT: One point sir in connection with that, in answer to your question, and that is that things will never stand still. They will either go up or down. If the tendency becomes accelerated, that our economy between the Atlantic Provinces and the rest of Canada becomes further out of line, we will or we could go back rather than forward, until those of us that do have to stay there are going to have a pretty hard time of it.

THE CHAIRMAN: I was going to ask you that. I was curious as to what the reasons were. I understand it is a good thing to have people stay where their roots are. I think that is a social aspect. I think the economics would be best served by mobility of the labour force. I would ask the economist. How about that Mr. Parks?

MR. PARKS: Yes, Mr. Chairman, I wanted to get in on this. Thank you. As you know, there has been a relatively high rate of out-migration from the Atlantic Provinces.

THE CHAIRMAN: What does "out-migration" mean?

MR. PARKS: Movement of people, Maritimers to other areas.

THE CHAIRMAN: Is it the same as emigration?

MR. PARKS: Yes. It is mainly to the centre part of the country.

THE CHAIRMAN: Thank you.

MR. PARKS: Earlier it was chiefly to the United States. Now I don't think that we should expect that this emigration is going to cease. I think we have to accept the fact that there is a considerable amount of willingness and desire on the part of labour to migrate, to be mobile and certainly labour has to be mobile in this very complex structure of society in which we are living.

In spite of the high levels of emigration from the Maritimes, and there is a considerable rate of emigration from Newfoundland within recent years, in spite of this, we have not been able to bring about any improvement in the relationship between this indicated or overall economic activity for which I am using personal income per capita in the region, and in Canada as a whole.

My point here is that emigration has not been a solution to the problem of economic growth. Now this is good. It is good that labour is mobile, and that labour has been able to move from this area to jobs which exist elsewhere, and I would suggest a considerable amount of mobility will continue, but we also have to look at another aspect of this problem of mobility. I don't think there is any doubt at all that more people within the Maritime Provinces, within the Atlantic Provinces will have to move from areas where they are now employed in subsistence and sub-marginal occupations, to those centres of industrial development which I was talking about elsewhere;

emigration from the Maritimes, from the region to other areas but it is a movement of people within the region and, of course, this type of thing is at the present time and has been for the last few years encouraged by the Government of Newfoundland.

RPS

Now, there may be an economic argument for the retention of people. We have stated in the submission that the majority of people who move from the Maritimes or have moved from the Maritime Provinces to other areas have been in the older aged group and have been relatively better-educated and better-trained people. If a disproportionately high number of these people move out this means we are not as well supplied with this group of people as other parts of Canada. Some of my colleagues who tend to be theorists will argue.

MR. MANN: He doesn't mean here.

MR. PARKS: Some of my professional colleagues point out, theorists will argue an abundant supply of well-trained labour will be an important factor in encouraging industrial location in the future. I don't buy this completely, but nevertheless I think this is one of the important factors in industrial location in the future, a good supply of well-educated and highly trained technical people, and if an area is relatively unsupplied, if I can use the word, with this type of person then this region is at a disadvantge compared to other areas where this situation doesn't exist.

COMMISSIONER MILNE: I think possibly, Mr. Parks, you might like to comment upon the significance of a statement that we have discussed, this is personal income differential, and I want to relate this in two ways to you. One is to the point Mr. Walls already brought up with you, the per capita income

in various cities in Canada. I was looking at something I clipped from the paper which has just been released by the Dominion Bureau of Statistics, taxation statistics by the Department of Revenue in respect to incomes for 1961. And this is a list -- I imagine you are quite familiar, but it has only just appeared -- this is a of the cities in Canada with more than 6200 taxpayers in the list. It totals 64. I am just talking about cities with a variance in per capita income, a few hundred dollars. One-third, roughly down is Welland and Belleville tied at $4,382.

Then I look at Regina which is thirty-third down in the list, $4,281. I look at forty-four, Halifax, Dartmouth, $4,180 and I look at Sydney-Glace Bay, number fifty-one, which is $4,055. Now, I also would like you to refer this to a study that I believe appeared in the Commerce Journal, 1962 which dealt with the Canadian Atlantic Provinces, a study in regional economic retardation and it is the one sentence there I really felt you would like to comment on:

"There appears to be a fairly high "level of disguised unemployment, that is "a situation where some reduction in "the employment of labour would not "result in the reduction in total production. "This is particularly true in the primary "sectors of fishing, forestry and agriculture, "and this condition undoubtedly has a "depressing effect on wage rates, not only

"in the primary sector but also in the "nearby urban areas".

MR. PARKS: Yes. May I ask, Madame, if the data to which you refer is that contained in the annual report of the Department of National Revenue?

COMMISSIONER MILNE: Yes.

MR. PARKS: This is data referring to the number of persons filing income tax returns?

COMMISSIONER MILNE: Yes.

MR. PARKS: Or the number paying income tax?

COMMISSIONER MILNE: The number of persons who pay income tax and the number of persons who filed returns.

MR. PARKS: Yes, this is the key to the thing I think. I think if we could go a bit further -- I realize there is no record of people who didn't file income tax returns so the point is all the people who did pay income tax, and these are really the people we are talking about in this report, the difference in comparing incomes between Halifax and St. John's and some urban areas in Canada is not very substantial, which really reinforces the point we made earlier on. We have to go further than this, I think, and compare the number of persons who filed income tax who didn't have incomes and then we could go further, if we could, and look at the number of people who didn't file income tax returns at all.

The point as I say there is no great contradiction between the figures of the one-third income

differential we were talking about before, the Department of National Revenue data refer to these people who do pay income tax, and these are people who are pretty well off and basically in urban areas. As the Royal Commission on Canadian Economics and Banking pointed out there is a disproportionately larger number of people who are not included in this realm of taxpayers at all and it is these people who bring down the average income.

Averages, you know, are misleading. They cover up a lot of things.

COMMISSIONER WALLS: Is that why you like to put them in as appendices to the brief?

MR. PARKS: The reason we used them is because this is the only overall thing we had to look at. With regard to the second point, and the second point you quoted from the Commerce Journal?

COMMISSIONER MILNE: Yes.

MR. PARKS: Who wrote it?

COMMISSIONER MILNE: William J. Woodfine.

MR. PARKS: Professor at St. Francis Xavier University. Yes, there is, I am sure, a great deal of disguised unemployment in the Atlantic Provinces. There are people who just don't show up in the employment data. These are people, they may be people who live on land and who sell X number of dollars worth of products but are pretty well idle a large percentage of the year. They may be owners of small fishing boats, but engaged also in subsistence occupations. I am sure if you get these people all counted in with the unemployed that we would have a larger number of unemployed than we do

at the present time.

MR. WALTON: May I make a further observation relating to the point Mrs. Milne has raised. Professor Woodfine, is, of course, most familiar with the situation especially in eastern Nova Scotia where we have been plagued with the problems of the coal industry. I think it is pertinent here that you mention in the statistics from the Department of National Revenue the relatively high position which Sydney holds. Perhaps it is not so high in terms of national revenue statistics, but if you refer it to the percentage of wages rates, industrial wage rates as Mr. Walls suggested earlier, Sydney comes out fairly high. The wage rates paid in the Sydney area are among the highest in Canada and yet I think it is equally important to realize Sydney is one of the areas that has been designated as an area of slow growth by the Department of Industry.

I think this bears out the fact that while averages may be misleading they are nevertheless good measures of the overall picture and the average per capita income covers the total income received in an area divided by the population. Certainly within this there will be people who come on both sides of the average. It doesn't measure the individual income. These are some of the problems which we have tried to point out through the use of personal income per capita data.

THE CHAIRMAN: I think there is uncertainty in the figure you suggest, but one must remember at the same time that one-third of the total taxpayers, those who

filed returns earned less than $3,000 so it is far above the average we spoke of. It is not at the bottom of the scale, moving out to nothing.

COMMISSIONER WALLS: You have come before us with a number of recommendations for alleviation of taxes in order to encourage secondary industries. I would be interested to know what you have done, and by you I do not necessarily mean your organization, but your province and your muncipalities in the way of self-help?

For instance, many secondary industries have been established in small centres across Canada through encouragement by alleviation of property taxation or by special rates for power. To what extent have you investigated this area as a solution rather than looking towards subsidization and tax alleviation from the Federal Government?

MR. PARKS: May I say a word about the activities of the Provincial Government in this field and ask Mr. Walton to comment on some of the steps which have been taken by some of the municipalities. Within recent years there has been a considerable emphasis in Provincial Government policy for encouragement of industrialization.

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This is particularly true for secondary industry and particularly true in Nova Scotia and New Brunswick. I think we have to realize that the problems of the other two provinces are a bit different than in New Brunswick and Nova Scotia.

Newfoundland has vast untapped resources which

haven't been exploited and there is considerable need for relatively large public investment in Newfoundland.

During the last few years we have seen in the Province of Nova Scotia the establishment of the Industrial Estates Limited, which is a Crown corporation and its main function, its principle function is to encourage the location of industry in Nova Scotia. The weapons available to Industrial Estates are several. They, for example, have built a number of plants. These may be leased back to firms or bought by firms. This is the sort of thing typical of the Industrial Estates' programme.

A number of firms have been encouraged to come to Nova Scotia basically, I am ready to believe, as a result of the activities of Industrial Estates Limited.

The Province of New Brunswick has recently set up the New Brunswick Development Corporation with somewhat the same general functions as Industrial Estates in Nova Scotia. The Province of New Brunswick is engaging in intensive advertising campaigns. These are the general types of assistance that the Provincial Government can and do give to industrial locations. There are a number of municipalities in the region who have made considerable effort to try to develop real estate programmes to encourage industrial location. Mr. Walton has just made a study of these and I would ask him to tell you about the activities of the municipalities.

MR. WALTON: Well, you mentioned, sir, the

possible role which the muncipal tax concessions might play in programmes of industrial development and granting of property tax relief generally for any new industries or perhaps an expansion of existing industries.

This kind of thing has been a feature of some muncipal government programmes which have been developed in the Atlantic Provinces.

I would like to say something briefly about what the City of Edmunston in northwestern New Brunswick has done over the last ten years. The programme was set up in 1950. The first thing they became involved in, they got authority from the Provincial Legislature in order to issue debentures to raise funds for the construction of factory buildings and they have made use of this authority on two occasions, both involving the same firm.

In 1953 a firm which is a textile firm manufacturing men's shirts -- this happened in 1953 and I think they began employing something like 50 people, mostly women and this was the problem that City Council was concerned with. Edmunston is a pulp and paper town and there are very few opportunities for female employment and they were very conscious of the need of developing this type of additional employment opportunities for women having in mind not only the needs of the City of Edmunston but also Manawaska County as well. They were successful in attracting the firm and in 1957 they issued further debentures because of the necessity of relocating the firm in a larger building. This particular firm has now expanded to the point where

they employ 250 people in Edmunston and also established a branch plant in the nearby town of Grand Falls which employs, I believe, another 75 people. This programme which Edmunston has mounted is carried out directly by City Council.

They have also in more recent years added an industrial loan fund to their weapons of industrial attractions, made use of this on a couple of occasions, and they do provide for municipal tax relief to be granted to certain firms which meet the criteria that they use.

It is a plan for a sliding abatement over a period of five years so during the sixth year the firm will be paying its full share for property taxes in the City.

Two other communities in the Maritime Provinces have engaged in this kind of thing. The most recent was in Moncton. They have established a development corporation which was instrumental in the location of Hinde and Dauché packaging firm in 1960. This development took place against a background of declining railway employment in the City and recognition of the need to establish new employment opportunities as an offset to this.

In Truro even more recently, only a year ago they established an industrial commission which has already been effective, played a part, a least, in the establishment of two or three firms in the Truro area. They have been assisted also by Industrial Estates which Mr. Parks has mentioned, the Provincial Government

agency in Nova Scotia.

I personally don't think that municipal tax concessions themselves are an appropriate means of attracting new industrial activity, particularly if you consider the industrialism need as a regional need. This could lead to the situation wherein one muncipality will be competing with another and probably offering more incentive than is required and when muncipalities are creatures of the province, and the four Atlantic Provinces are low income provinces and they don't have the financial resources at their disposal to have this kind of competition going on, and I am afraid it would not lead to the most economic location of industries. At the very least it would have the danger of leading to industry locating in a place where the profit prospect and long-term prospects are not best.

I myself think that the most important contribution could be made by muncipal authorities through, first of all, carrying out the process of civic administration efficiency and effectively.

RPS

This is something which income industries will look at and be quite concerned about but I also think they have to be aware of the kinds of advice and information and assistance which newly-established and existing industries will require. They have to have some knowledge of what is involved here, and I think here is the area where municipal Government in the Atlantic Provinces can best expend their efforts and perhaps achieve the greatest results.

COMMISSIONER WALLS: Don't you have some Provincial taxes that they do not have elsewhere that discourage industry? I am thinking particularly of the fact that your motor fuel tax is half again as high as is charged in other industrial Provinces; with Provinces like Nova Scotia the highest in gasoline and second in diesel tax, and New Brunswick highest in diesel and second in gasoline tax. There is such a big disparity in the amount of tax through that. None of these things, in themselves, any more than what you are asking us for is going to bring industry.

If you are going to come to the Federal Government for concessions, surely there must be some that you can get provincially. You also have a tax, I believe, on long distance calls that they do not have in other Provinces of Canada.

MR. WALTON: I may comment on that. I think that this is a very valid point, that the incidence of Provincial taxation may fall more heavily on industries in the Atlantic Provinces or, indeed in any low-income area, than they do in other more prosperous

regions but I think that this is a function of basically -- first of all, the fact that the Provinces are low-income Provinces, they have very little freedom to manoeuvre; very little opportunity to allocate a portion of Provincial Government expenditures to industrial attraction and this is, in turn, a function of the lack of economic development and it's a bit of a vicious circle proposition and our recommendations in the past few years have been made against this background, and our suggestion has been that by themselves, as much as they try and as much as we are continuing to try, the Provincial Governments cannot exert enough -- cannot by themselves achieve this purpose of raising economic development in the Atlantic Provinces. It does require the participation of the Federal Government and I don't, sir, want to become involved in a discussion of Federal-Provincial relations at this point but this certainly is pertinent here.

THE CHAIRMAN: I think we are just getting warmed up, but before we do I think we better break for 10 minutes.

---A SHORT RECESS.

---FOLLOWING THE SHORT RECESS:

MR. MANN: We are delighted to see that you have arranged with the press to have one of our own people here today to take the notes. Mr. Stewart MacLeod from Sydney.

COMMISSIONER WALLS: He is one of the emigrants that you are so interested in.

THE CHAIRMAN: We looked at it very carefully and examined the fairness of it. Now we had got to the point where I think Mr. Walton was just describing the success of certain municipalities in encouraging industry in reply to a question from Mr. Walls I believe.

Do you wish to proceed with this?

COMMISSIONER WALLS: Well you don't mind if I jump over to another one, to recommendations?

THE CHAIRMAN: Before we get there, I was really curious as to what you were able to tell us of the success of legislation in Canada directed towards the end that you spoke of, or if you like, in any other countries. You have described some legislation in other countries. We are very much interested in the effects of taxation and in section 4 you speak about the Canadian concessions with regard to depreciation and you mentioned that this resulted in a substantial capital expenditure. I wonder whether you can say that capital expenditure would not have occurred without this particular legislation? I presume that it would not. I am looking at pages 27, 28, 29 and 30.

MR. PARKS: Mr. Chairman, this is a question in which we are very much interested, and we would have liked to have been able to provide some quantitative measure of the effect of various types of incentives on industrial locations.

I might mention sir also that the Atlantic Provinces Research Board, to which Mr. Mann

referred earlier on, has a commission to study this picture, which is now underway by Professor Thomas Wilson of the University of Glasgow and he is also very much interested in this matter of quantitative measures, the effect of various types of incentives. He, likewise, has been up to this point unable to get at this type of thing, but the Research Board has under consideration a questionnaire leading to a study, a questionnaire which will be directed to certain manufacturing establishments which may lead to a study of this type of thing, but this is a relatively ambitious thing and the Board just has not got into it yet.

The point here is that we have found it impossible, at this stage, to provide this type of quantitative measurement. Now with regard to the observation you made sir as to the relationship between the incentives or concessions mentioned in section 4, I would like to refer to paragraph 60, page 30 in the text of the submission which reads as follows:

"There is no means of determining "the exact incentive value of the double "depreciation provisions in encouraging "this new investment in labour surplus "areas. It is not possible to determine what "portion of it would have taken place with- "out the incentive, what portion was due "to factors other than this particular "incentive, and what portion was due directly "to the double depreciation provision."

THE CHAIRMAN: Now if you had the choice of

conceding some amount of tax by way of depreciation, or by way of straight reduction in tax rates for those areas, which do you think would be more effective?

MR. WRIGHT: This would be one or the other?

THE CHAIRMAN: Yes. I am trying to weigh up your priorities in this matter. I am rather suspicious that one concedes these tax considerations because they appear not to cost anything. Whereas, they do. Certainly they cost something, and if one is going to set aside a certain amount of money to be used through the Income Tax Act to pay for concessionary legislation in respect of the Atlantic Provinces, which would be the most effective thing to do? Cut tax rates in that area or would it be better to allow depreciation to encourage people to spend more capital?

MR. PARKS: This probably sir should be related to something we said earlier. The need of the Atlantic region is to attract industry in growing and dynamic areas of economic activity. It may be that there should be more discrimination in the application of a tax concession than would be involved in a straight across-the-board cut in the rate.

What we are interested in here is the greatest possible assistance to economic development, and I would suggest that this would come about as a result of direct encouragement of these areas by industrial activity, which I have mentioned and this is why I say that it may be necessary to introduce some degree of discrimination.

THE CHAIRMAN: Discrimination as between what and what?

MR. PARKS: In favour -- discrimination in favour of these areas of economy, of manufacturing in general, if you like.

THE CHAIRMAN: Discrimination between areas?

MR. PARKS: Discrimination between other types of taxpayers.

THE CHAIRMAN: Discrimination between areas?

MR. PARKS: As between areas and as between types of firms within an area.

THE CHAIRMAN: What kind of firms do you want within an area?

MR. PARKS: We have concentrated in this submission on manufacturing and processing. Now if the rate of taxation for these firms can be different than the rate of taxation of firms in other areas of economic activity, then I am afraid sir that I cannot answer your question as to which of your alternatives would be most successful, but I can only indicate we should, I think, keep in mind the ultimate objective of this type of thing.

MR. WALTON: I presume one of the reasons, or one of the characteristics of the double depreciation provisions, for example, which are included in the supplementary budget of several months ago is that they do offer an opportunity to select particular types of industry to be assisted. If you had a flat reduction, for example, to be applied to a particular geographic

area, or, indeed, even to a particular sector of the economy, particular type of industry, then you probably encounter problems, technical problems as to how you define these areas; whether it will be available, for example, only to new firms or to expansion of existing firms, and this kind of thing.

Now I don't profess to know how these technical considerations can be sorted out.

THE CHAIRMAN: I was really thinking in terms of suggesting that there were alternatives to cutting the rate. The other was to allow some greater depreciation or investment allowance, or something of that order. One alternative against the other. I was thinking of permitting those alternatives in exactly the same place under the same conditions.

MR. WALTON: Well it seems to me that you can make a very good case for saying that the kind of assistance provided by the 1960 provision of double depreciation could be provided just as well through the provision of the grant to the firm which might come from Federal sources, Provincial sources, or what have you. The effect of the double depreciation, as it was called, which is simply a faster write-off of the asset involved, is simply to provide to the firm an additional amount of working capital during the period in which it chooses to use the faster write-off, usually in the first two or three years.

Now tax incentives in European programmes, generally speaking, have been used for quite different purposes. They have been used as a long-term reinforce-

ment to the grants and loans which have been provided to cover the kinds of additional expenses, and what not, the firms require but I think this particular example of the double depreciation introduced in the supplementary budget of December '60 is not the kind of long-term reinforcement tax concession which we favour.

THE CHAIRMAN: And then if you were taking a sum of money dedicated to the development of a certain area, the choice that a Government would have would be many: concede customs, concede sales taxes, provide loans for plant, loans for other purposes, low interest loans and then going to income taxes, one could reduce the rate, allow capital cost allowances, thing of that nature.

Would not the expenditure of the money be most useful if it were devoted to paying part of the capital cost or providing cheaper money to get things started rather than giving up a share of the profits? When the profits come along, it is not as important, I wouldn't think as the money required to get things off the ground. Am I not right?

MR. PARKS: Yes, I think that is right. The big problem facing industrial accretion is the initial period and this can be provided through a number of means; may develop programmes by grants or loans; by the building of advance or custom-built factories.

RPS

MR. WALTON: It is as a long-term of encouragement that tax incentives usually appear.

COMMISSIONER GRANT: Mr. Parks, do you see any sort of tie-in where the present programme of capital investment being carried on by Industrial Estates could be augmented by the incentive programme whereby tax relief is given in the form of 50 per cent write-off in depreciation and in income tax, income tax exempt. That is depreciation on the straight line basis, I believe, rather than on depreciated balance. Do you see that this tax incentive, Federal tax incentive, could work in conjunction with the capital programme financed by the Province?

MR. PARKS: Yes, sir. That is a situation I think we already referred to. The initial capital requirements for location are partially provided by Industrial Estates. This is an encouragement to get industry there, get the firm there, get production going, and this I think might very well be supplemented by, in the long run, by the type of tax incentive to which you have referred. As a matter of fact this is the case in some other areas, in some other countries although, granted, the situation is different because there are two levels of Government involved here.

COMMISSIONER GRANT: Our Federal Government is thinking not in terms of capital assistance but in terms of tax concessions whereas our Provincial Governments in New Brunswick and Nova Scotia are certainly on a programme of capital assistance.

MR. PARKS: That is right, sir.

COMMISSIONER GRANT: While the Federal programme refers to new industry, I believe, which could be a restrictive type of concession insofar as any tie-in with the Provincial programme is concerned because the Province doesn't restrict its help to location, it will assist existing industry if it is convinced it needs to. For two programmes to work together in assisting in industry already established in a Province that wished to embark upon another type of processing or manufacture, it would have to be done, I should think, by a separate company. As long as it is a new industry, as I understand it, who owns that industry has no bearing on it, it could be one hundred per cent a subsidiary; is that right?

MR. PARKS: Well, I am not sure, sir, of the interpretion which is going to be placed on the word "new". If it is the case I would think that is right.

COMMISSIONER GRANT: That is a rather material point, don't you think, as to whether or not an existing industry can embark on a new process of manufacturing?

MR. PARKS: Yes. This, I think, is very, very important. What the Atlantic region needs is much new investment, the encouragement of branch concerns, branch plants, if you like, or new employment creating expansion at the present site -- it is just as important from this point of view as the encouragement of completely new enterprises. These type of things we are suggesting should be encouraged as well as completely

new enterprises.

COMMISSIONER GRANT: I think it is important that there should not be a hiatus develop between the Federal and Provincial programmes with industry saying we are perfectly willing to locate in the region, we want to take advantage of the tax incentives which the Federal Government is offering, but we don't want to go into any capital expenditures at the present time, if you put a plan out for us we will go ahead.

Now, if the Provinces say we will put your plant up, but the Federal Government says you are not the type of industry, it isn't new, you can't take advantage of the tax concessions, this could lead to the situation where nothing happens so there could be -- that situation may require improvement.

MR. WALTON: On this particular point which Mr. Grant has raised I think it is awfully, awfully important if a programme of regional development is to be successful, it is important that a considerable degree of co-ordination exists in this general area of industrial location and economic development between the Federal and Provincial Governments. I would hope that the Atlantic Development Board, for example, might emerge as a co-ordinating agency here because it has resources at its disposal to assist in the process of regional economic development and is possibly in the best position to act in a co-ordinating capacity and be aware of what is available through other Federal agencies in the form of assistance to new industries.

It is perhaps even more important that

co-ordination exist between the Federal Government and the Provincial Government agencies in this area because the location of industry under our Constitution is the responsbility of the provinces and it is in the area where the provinces will make the contacts with industry and will be dealing with specific firms. I think it may be very very difficult indeed to achieve any progress along these lines if we don't have this kind of co-ordination between Federal and Provincial Governments.

MR. MANN: Mr. Chairman, in making the suggestion as we do that agencies such as unit occupation boards be established -- this was our thought that there was this tremendous need for co-operation and co-ordination and I feel that I can say in my view that this is one of the problems that the Planning Development Board has to resolve in their early stages. They have to decide whether they are going to assist temporarily in the infrastructure side or they will help in direct assistance, but certainly they are not -- I don't believe they will be in a position to say exactly what they are going to do, and we hope that it will be a combination of both because we think that while the co-operation and the co-ordination is essential that there must come in the long pull from the Federal level, as monies are just not available to the Provinces to go out and do all the things that they must do, that here is an area in which the Federal Government can assist and they will look at this problem carefully.

In taking up the cudgels for the region here

we are, and this is what we are trying to say to you, that you may in your wisdom influence, if you will the thinking toward this end. This is terribly important to us.

COMMISSIONER WALLS: It seems to me that the whole crux of your presentation is in one sentence on page 21 where you say: "Canada continues to consider taxes primarily as a means to produce revenue rather to achieve and promote economic growth". There is no doubt there are many people who believe that the main function, if not the sole function of collecting taxes is to raise revenue as equitably between individuals as possible and as administratively easily as possible and then to look to other forms of legislation to subsidize the economic growth. It is quite apparent you have given considerable thought to this and you really tend towards the thought that taxation should be the vehicle used for economic growth as well as revenue producing. I would like to get your ideas on that.

MR. PARKS: Yes, sir. I think that taxation came to be accepted as an instrument, as an economic instrument, as an instrument to play a role in smoothing short-term business fluctuations. I think it is true, sir, many countries in the world do accept the fact that taxation did have and does have a role to play in, as I say, trying to control the short-term business cycle. More recently people have begun to look at, economists concerned with economic development problems have begun to look at the use of taxation as a role not only for

producting revenue to meet expenses of Goernment but as a means to smooth out short-term business cycle and as a means now to encourage long-term economic growth.

COMMISSIONER WALLS: There are only two things I would like to put to you here: taxation usually is a much slower method of making adjustment because when a Budget comes down invariably it affects taxes collected a year later, whereas by separate legislation or separate subsidy it is possible to put the corrective factors into effect right away. The other point that I wonder about is that you mention that this philosophy was used by certain European Countries. Have you any means of stating actually whether the tax adjustments or subsidies or easements achieved the purpose or whether it was other factors? Have we anything definite to be able to put a finger on that when you use taxes, or if any country has used taxes to create economic growth impetus, that it has actually accomplished it, rather than some other factor at the same time?

MR. PARKS: Yes, again I think it is impossible to offer any quantitative measurement of the import of any one of these policies. There are a number of quite separate policies which have been adopted in Europe and in North America and just what effect any one of them has by itself is very difficult to measure in the first place because there is an inter-action among them. I don't know that it is a question that is quantitatively answerable for this reason. It is generally assumed, I think, that the

levels of taxation in one case might be high enough to discourage investment and discourage consumer spending and this type of thing and there are other people who claim there are other aspects of taxation which tend to discourage economic development. It is pretty much based on observation and the direct day to day contact inthe course of economic activities rather than any sort of exact measurement.

Further to what you said, sir, in regard to the use of taxes for short-term purposes, and I think probably it is true to say that the use of taxes for this purpose is accepted, not only in Europe but in North America as well. I think we have used taxes for short-term purposes in both Canada and the United States, and now in the United States and in Canada I think there is some use being made of taxation for purposes of encouraging growth in the long run. I agree with you that the impact of taxation is likely to be slower than the impact of some other policy, but at the same time we have to remember that economic growth is a long-term process.

MR. MANN: Mr. Chairman, last spring I spend part of a day with Dr. Beddy in Dublin and we were talking about this very problem, Mr. Walls. He went on to explain to me that the development that had taken place in Shannon where they provide a plant and lease or almost give it to the people who come in. This was important, he said, to get the people established but the free tax or nontax atall until 1980 was to keep them there.

I know of no country that is as generous in their treatment of industry, to attract them to the country as is Ireland. When you think we are competing with a group of people who are not only building plants and giving as much as 75 per cent for them to come and then giving free taxation until 1980, we are really up against a pretty competitive country. This was the reason, you need to get them there and you need to keep them there, and tax advantage was to keep them there.

MR. WRIGHT: Mr. Chairman, I believe that there are two factors or considerations in an industry, that may be involved in an industry establishing in a certain area. One may be lack of capital which could be a stumbling block and which probably could be overcome by provincial assistance or some industrial assistance or something like that. The other may be a case where capital is not a question, sufficient capital is available and there the long-term tax incentive is the thing that attracts.

I am thinking of branch plants of large concerns which may be located in some other part of the country and which could establish in ours providing certain concessions were there or could be got that would get them there rather than someplace else. I am not writing off the rest of Canada for the Atlantic Provinces but the point is we do need these things. In other words in my opinion we need both these things. We need availability of capital and we need more than that to carry on, to encourage our industry to stay there.

THE CHAIRMAN: Surely tax exemption, the

exemption from tax, there being no tax -- nothing could be better than that, I would think. However if you are going to attract people because of exemption from tax they have got to be in a position that the taxation based on their profits would be such as to make a difference between whether they got a good return on the capital investment or a poor return on capital investment.

There may be people in these circumstances. In many cases there may well be a good return with or without taxes because taxes are a share of profits. It is not a cost. It is a share of profits. In many cases there may be a good return with or without taxes, but it is true there will be a class that fits in the middle. It is terribly hard to decide just how wide that class or how many people are going to be influenced by it. I think there are better things to do than consider taxes because when you are considering taxes you are only giving it to people who would be influenced to move in -- you are making a concession to people influenced by taxes. You may be spending money needlessly. If you are making concessions to people in cases where they wouldn't come otherwise, giving concessions of the kind that would make them come then all your money would be well spent.

I think one must be pretty careful with regard to this. As I see taxes they become pretty popular throughout the world. Ireland, the West Indies, many European countries make concessions, Italy, Sicily makes 10 years' concession -- all kinds of concessions.

They are easy to give. They don't stick out and confront you the way a subsidy does.

PS

But even so they are costs, and it is the lack of giving anything, in my view, which sometimes makes them attractive to Governments. I think we have got to be very careful to hit on the right kind of incentives, and on incentives where we spend our money always to good purpose, not only some of the time.

Therefore I say what evidence have you as to the effectiveness of these concessions? When you say you are having Professor Wilson examine the concessions which he can find out about, and report, we would be extremely interested in learning of that at such time as he completes his report. That is the kind of information which is extremely interesting to us.

MR. MANN: I don't really think we can give you any better answer than Mr. Parks has provided, and perhaps my very brief resumé of what Dr. Beddy said when I saw him in Dublin. We concur, I am sure, with your views in this and feel that this is so.

I know that when we are making a presentation on behalf of the Atlantic Provinces, as we are doing today, we are thinking of regionalism in Canada and development of it is not in the Atlantic region as such, but regions within Canada that need this kind of attention.

COMMISSIONER GRANT: In your brief you state that industry looks to certain basic things when it is going to establish in a particular area, and this is manpower, raw materials, transportation, utilities and you outline those things in your brief. This is

something like the elementary principle of physics, that water seeks its own level but physicists also admit that at times a forced pump is desirable to put water where you want it and that, in effect, is what you are asking. You are asking there be some forced pump application applied to the Maritime region. Ultimately, in the long run, as your brief pointed out, it's for the good of the whole country because I think at one point you state that had the level of income in the larger Provinces in the Atlantic region been the same as it was throughout the Canadian average, that it would have put something like $800 to $900 million more into the Maritime Provinces in the last 10 years, which would have increased their purchasing power.

MR. PARKS: Mr. Chairman, I think Mr. Grant has provided an extremely interesting example of the type of thing we are talking about. Many of the factors of production are already located in the Altantic Provinces.. There is the condition for industrialization but more than this, there is the industrial location which already exists in other parts of the country which does not cause industry to gravitate to other areas.

This situation does not exist in the Atlantic Provinces and as Professor Cairncross pointed out, Dr. Cairncross pointed out in the study he did for the Atlantic Provinces Research Board sometime ago, nothing succeeds like success. It is true of industrialization as it is true in anything else. Once you have the industrial complex, you have industry

tending to gravitate towards this.

We are not suggesting that industries which have no chance of becoming successful whatsoever, should be assisted in locating in the Atlantic Provinces. If this were done by tax incentives, this would be unfortunate for the national revenue; unfortunate for the regions that chose to encourage a firm to come in which was almost sure to fail in a short period of time. There are costs involved and there will be costs involved, but there will also be costs involved in maintaining the situation which exists now.

We tried to do some or provide some measure of the amount of income which was lost to the Atlantic Provinces as a result of higher than National unemployment rates in the region, and I think after we had gone through a number of mathematical contortions, we came up with the result of $453 million in income lost over an eight-year period, something like this, simply as a result of higher than national unemployment rates in the Atlantic Provinces. This is a cost, of course of maintaining the situation which presently exists.

COMMISSIONER WALLS: I just have one more question and that is in regard to your last recommendation that the sales tax be moved from building materials as an incentive to new industry and I would like to draw to your attention that we had some participants a few days ago who are manufacturers who admitted that they had taken part in representations to the Government opposing the taxation of building materials but that when we put the question to them: if you were

deciding on building a new plant would the tax on building materials come into your consideration or not, their answer was: In our primary consideration, no. They wouldn't give that as a reason as to whether they built a plant or did not build a plant. To what extent do you think, in the Maritimes, that this tax on building materials would be a deterrent towards the plants being encouraged into your Province?

MR. WALTON: Well I think, first of all, the recommendation in this regard is the only recommendation which we are making as a general recommendation in terms of the conditions within the national economy. The others are related specifically to the Atlantic Provinces and I am not sure that I can answer your question with specific reference to the Atlantic Provinces, but I will try if I might to relate it to Canadian conditions generally and hope that this may have some application to the Atlantic region.

The important thing, it seems to me, is the long-term significance of this particular addition to taxation upon the competitiveness of Canadian industry. According to Mr. Gordon's figures, when he introduced the Budget June 13th, the additional revenue to be derived from the extension of the manufacturer's sales tax to these new categories of production: machinery, equipment, building materials, subject to certain exceptions would amount, in a full fiscal year, to something like $385 million and he estimated that without this change to manufacturer's sales tax in 1960 -- I think 1963/64 -- it may have been 1964/65,

would have amounted to $840 million, so this represents a 46 per cent increase in the revenues to be derived from the manfacturer's sales tax.

Still following up the manufacturer's sales tax, according to the original figures the level with a full fiscal year was 1.2 billion dollars and the corporation income as a Federal revenue producer, I think the figure used for corporation income taxes at roughly the same time would be 1.4 billion dollars of revenue and personal income taxes provide 1.9 billion dollars of revenue.

It seems to me that the significance of this extension, which is large in these terms, is made all that much larger by the fact that it is applied selectively and specifically to those goods and services which are consumed when new investment takes place, production machinery and equipment and building materials are required which manufacturers, Government, everybody will buy when they are building something, and I think the important thing here is the fact this may have opened private investment spending.

Now some businesses may argue that this will not bother them particularly, as long as their expected return for a long period of time will exceed the cost today of raising funds. As long as there is a reasonable return they would proceed with it.

I suggest the additional cost which is built into this must be recovered by the firms undertaking the expansion from the sales of their products, and I suggest, therefore, that this may have a rather

serious effect upon the level of prices of Canadian-produced manufactured goods. Now in these circumstances it may well be that the apparently effective devaluation of the Canadian dollar eighteen months ago, which has led to the expansion of manufacturing activity in Canada, especially in Ontario, indeed to the expansion of the export manufactured goods, that this may wipe this out completely and this may have very serious repercussions, not only in the Atlantic Provinces but throughout the country.

I think our reasons for inserting this particular recommendation into our brief is that we believe that the further development of the Canadian Atlantic Provinces, of industry in the Atlantic Provinces depends, first of all, on the maintenance of an adequate growth rate, rapid growth rate in the country at large, and secondly, that that will more easily take place in a climate of expanding world trade, the expansion with Canadian participation, particularly in manufactured goods in world trade.

There is another consideration I think which is the one which we have perhaps emphasized in the brief, and that is that given the slow rate of growth which has taken place in the Canadian economy in the period since 1957, there has been some improvement in this situation as the Chairman has already noted in the last couple of years, but, nevertheless, in this situation any action taken now which is apt to prejudice or offer an impediment to new productive industry, we are opposed to and consider this inappropriate

in the present circumstances but also as I have tried
to point out, inappropriate from a long-term point of
view having regard to Canada's competitive position in
the world economy.

COMMISSIONER WALLS: The only thing that
disturbs me, and I am going to lead to a question, is
that you have asked here for certain concessions. The
2 revenue that is taken off has to come from somewhere.
We have had participants before us recommending cuts
in income taxes in both upper and lower brackets.
We have had participants in front of us asking for all
or part of the corporation taxes to be removed and
generally their answer to it is that the lost revenue
be made up by consumption taxes.

Now the question I am going to ask you:
if you are going to make it up by a consumption tax,
a sales tax, and you don't want it on building material,
which of the present exemptions then should now be
taxed without it becoming a regressive feature whereby
the poorer people would be paying a higher percentage
of taxes?

MR. WALTON: May I answer your question assum-
ing conditions in which we have a more rapid growth
rate which to me, in the national census would be
considered an adequate growth rate, our employment
situation is sound and, generally speaking, we are
in a period of prosperity and expansion, then in those
circumstances I personally would tend to favour the
raising of additional revenues through a general increase
in tax rates applied to corporation income taxes and

personal taxes as well because in such a situation your problem may be, the danger may then be inflationary pressures developing, and so on, and you can apply the brake to this as to the level of final demand but at the moment the problem with which your Commission is faced, Mr. Chairman, is made awfully difficult by the fact that we do not have these kinds of conditions. We do not have an adequate growth rate in Canada.

Therefore, at this particular time I think it is unrealistic to try to achieve, in a short period of time, a balanced budget. I think we must aim, if it is the desirable goal of public policy, we must aim for this over a longer period of time and that this will require, as is mentioned in our submission, the use of additional deficit financing but with the application that your whole conduct of economic policy by the Federal Government and, indeed, by the Provincial Government as well must be conducted in the way which would stimulate the economy to achieve this faster growth rate and this, of course, is the argument which is being used and nobody can prove it or disprove it at the moment.

In the United States, for example and the Council of Economic Advisers in Washington have pinned their whole reputation on this. If the tax cut proposals do not have the effect of making some dint upon unemployment that exists in the United States, certainly there will be some reconsideration of the recommendations which have been put forth by the administration.

I don't offer any easy solution to this

problem. I don't think anybody can, but I think in the long run the interests of Canada, that it is more important at this stage to do whatever we can to ensure that we do achieve more rapid rate of economic growth than we have experienced in the recent past and that other considerations, these other goals of public policy which may be perfectly appropriate, will be better looked after in the long run if we set the initial conditions straight in the first place, and then worry about these problems later on.

MR. MANN: I think, Mr. Chairman, what we should do is record Mr. Walton's comments here as his comments with respect to your question. Whereas we, as he indicates, have not got the answer. We don't pretend we do have it. This is what we generally think is a reasonable reply to this question.

COMMISSIONER GRANT: Would Mr. Walton relate our unsatisfactory growth to this serious imbalance of trade which has been brought to our attention forcibly in the last three or four years than ever before. That is to say, would you think that our economic growth could be stimulated more by the development of secondary industries in Canada or more by development of export trade, or a greater amount of export trade?

MR. WALTON: Well I will try to answer the first part of your question rather briefly because it raises rather a broad area of examination in which the problems are rather complex.

I do not believe that the problem of too

slow rate of economic growth in Canada resulted from the imbalance in our international payments. I think it is a reflection of a general problem of world equity, the solution to which Canada may participate in but we cannot sort this out by ourselves. This is a problem which the United States, for example after some years of not being very concerned with is coming to recognize and becoming very much concerned with in recent months.

I think, in fact, it is the other way around, that our growth rate, the attainment of sufficiently adequate growth rate may be stifled by too much concern for the short-term planning of international payments, and that the solution there lies in the extended availability of international liquidity rather than actions anyone might take.

To the second part of your question, as I understand it, would I prefer to see greater expansion of secondary manufacture in Canada as opposed to greater expansion of export trade, if I interpret that question correctly you are suggesting it is an alternative, one or the other.

COMMISSIONER GRANT: I shouldn't not necessarily, but on which would you place the greatest emphasis?

MR. WALTON: I shouldn't like to place emphasis on one or the other. I think from the point of view of Canadian trade and commerce policy that it is essential, in fact, to achieve -- it is true in the past our export trade has developed mainly on the export of primary products, but in future given the fact that our population numbers, therefore our labour force grows and the number of jobs required will demand a further processing of many of the primary products in Canada, demand development in Canada of new secondary manufacturing industries which we wouldn't then have which we may have to a limited extent, and that therefore I really think that both things are necessary over the long pull, and I think we need exporting

of secondary manufacture, and I think in order to get this we need expansion of export trade, not only of primary resources, primary products, but also secondary manufacturing goods.

THE CHAIRMAN: We wouldn't develop our secondary industries, as we said here earlier, if we are solely dependent on our own consumption.

MR.WALTON: I don't believe we have any hope of developing additional secondary manufacturing in Canada purely on the basis of serving Canadian markets.

THE CHAIRMAN: This has been a very interesting morning for us. We are very grateful to you, indeed. You have helped us to understand the regional problem, certainly the Atlantic Provinces, not perhaps the whole regional problems. We will continue to consider these difficulties. Have you anything further you would like to say to us? We have completed our questions?

MR. MANN: No, I think not. I think that from our point of view the questions which you, Mr. Chairman, have posed to us earlier and particular with respect to secondary industry and our pointing out what we think to be necessary development of poles of growth in specific parts of our region and the development of our secondary manufacturing, as Mr. Walton has discussed goes along with the export trade. We need to develop this. We need to develop it and analyse by study our local needs and our export needs. We think we have real opportunities in the future if Federal

legislation and Provincial legislation and municipal legislation will dovetail to the extent that this programme can get underway. It is in this direction this group, A.P.E.C. is trying to steer the Federal people in our representations, and on the Provincial and municipal level. We have just completed a conference, a very successful conference of A.P.E.C. with community and municipal developers and it was really thrilling to see the enthusiasm of a lot of the people attending this meeting when they left.

Meetings after all are meetings and conferences are conferences but this was the best one we have had. It was encouraging to us because they feel on the community level which we are dealing with that they can go out and undertake some of the things that were brought up before by the Atlantic Development Board as meeting its thinkings. The Atlantic Development Board, in its thinking, together with the Provinces will lead to a greater future. We know it is going to take a long time. It is not going to be done by tomorrow. It will be a long time before it happens.

We do feel that we must become on a level of greater equity with the rest of Canada.

MR. WRIGHT: Mr. Chairman, I would just like to express myself how much we have appreciated this opportunity to be heard and thank you and the members of your Royal Commission for the courteous way in which you have listened to us while we were submitting our proposals. I can only point out that I hope we have been able to do something, to get across

clearly, express our ideas as clearly as possible. We are very much, as Mr. Mann has stated, we are extremely interested in this thing. We will be grateful for all the assistance we can get. We hope that we have made our submissions clearly.

We thank you very much, sir.

THE CHAIRMAN: Thank you, Mr. Wright. We certainly commend the efforts of your organization. It has a worthwhile objective. We thank you very much indeed, Mr. Wright and gentlemen for appearing before us this morning.

Mr. Secretary, you have a couple of matters you want to put on the record?

THE SECRETARY: I have two briefs, Mr. Chairman, I wish to enter into the record. One is from the Canadian Association for Adult Education and will be Exhibit 243 and another one from Mrs. Gila Bauer of Hampstead, Quebec, I would like to enter as Exhibit 244.

---EXHIBIT NO. 243: Submission of the Canadian Association for Adult Education.

---EXHIBIT NO. 244: Submission of Mrs. Gila Bauer.

THE CHAIRMAN: We will stand over until 9:30 Wednesday morning.

---WHEREUPON THE HEARING ADJOURNED UNTIL 9:30 A.M., WEDNESDAY, THE 6th DAY OF NOVEMBER, 1963.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT

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THE ROYAL COMMISSION ON TAXATION

Hearing held in the Centre Court Room, Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, on Wednesday, the 6th day of November, 1963.

COMMISSION:

MR. KENNETH LeM. CARTER -- Chairman

MR. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

MRS. S.M. MILNE

MR. CHARLES WALLS

LEGAL ADVISER:

MR. J.L. STEWART, Q.C.

RESEARCH DIRECTOR:

PROF. D.G. HARTLE

SECRETARY:

MR. G.L. BENNETT

* * * * *

---ON COMMENCING AT 9:30 A.M.

THE CHAIRMAN: Mr. Secretary, I think we might start.

THE SECRETARY: Good morning Mr. Chairman and Commissioners. The first brief this morning is being presented by the Associated Factory Mutual Fire Insurance Companies. Mr. Ambrose B. Kelly, General Counsel is appearing to speak to the brief which I would enter into the record as Exhibit 245.

---EXHIBIT NO. 245: Submission of the Associated Factory Mutual Fire Insurance Companies.

SUBMISSION OF

ASSOCIATED FACTORY MUTUAL FIRE INSURANCE COMPANIES

Appearances: Mr. Ambrose B. Kelly

THE CHAIRMAN: Thank you. Good morning Mr. Kelly. We thank you for your submission to us which we have read with interest and which we are very glad to have, I might say. Would you tell us about the operation of a factory mutual. I think I understand it but I would just like to be sure that I do. It is a mutual, obviously, and I see by the brochure that you started insuring textile factories. Would you have a balance sheet, I presume, which is published for these companies?

MR. KELLY: Yes, there are separate companies

in the factory mutual group and each one of these files its annual statement with the Dominion Insurance Department because they are all licensed in Canada under the Foreign Insurance Companies Act. I didn't bring with me balance sheets of the companies. It would be a simple matter and I would be delighted to file with you statements of each company.

At the request of, I believe it was the Secretary when your research staff asked for some information I sent up the annual statement of one of the companies, the largest of them, Manufacturers Mutual Fire Insurance Company as illustrating the nature of the group.

These are all large companies as mutual insurance companies go. The combined assets of the group at the moment are just slightly under half a billion dollars, $500 million. I prepared and I have in my brief some illusion to the fact that we have very substantial funds in Canada.

At the moment our Canadian investments of the seven companies of the group total $21,945,000. We have in our Canadian investments in our bank balance in Canada a total of Canadian assets at the moment, at the close of last year, which is the date of which I have figures available, $22,761,605. These are supporting over $5 billion, $5-1/2 billion in insurance risks, almost entirely manufacturing.

You have eluded to the fact that our company started in the textile field. Let me for just a second give you some of our history. The first of the

factory mutuals was established in 1835 because a gentleman in Providence Rhode Island who happened to be both an engineer and a textile manufacturer had built a new woolen mill and he installed in this mill every device known -- this was before the day of the automatic sprinklers -- that would ensure its safety against loss by fire. He had fire pails everywhere. He used non-combustible construction as far as possible.

He tried to make certain that his mill would be, according to the knowledge of that time, protected against risk of fire.

When it was completed he went to his local insurance agent and asked what the rate would be and he was told the rate would be $2 per $100 insurance. He complained. He said this is the same rate you charge other cotton mills. You are making no difference between my new mill in which I have spent a good deal of time, effort and money trying to protect against fire and the mills that are fire-traps, which are of combustible construction and where the people who are owning them haven't used any intelligence in protecting themselves against loss by fire. They said, no, Mr. Allen, the rate for textile mills, for woolen mills is $2. We must depend on the average. We don't discriminate. We charge all the same rates.

Allen, having independence of mind, which we think of still as a Rhode Island characteristic was unwilling to accept this answer so he talked to other owners of mills, who if they weren't up to his standard were at least interested in ~~having~~

protection. He said, why should we carry losses of careless people. Why don't we organize a mutual company? Mutual companies were well-known at that time since the first company in the United States of continuing history, the Philadelphia Contributorship, New England Dwelling House Mutual had been formed, many of them in the period between 1800 and 1820, so that the idea of mutual insurance was a common thing in New England.

What Allen did was take the basic principle of sharing of losses and limiting the cost of the insurance to be determined by the experience of the people who were in the mutual and moved from the field of private residences and the small individually-owned property into the industrial field.

This first company was quite successful. They used the rates in the beginning, they charged the rates based on the schedule used the the Etna Fire Insurance Company which was in existence then in Hartford. They found charging rates slightly less than Etna they could return to their policyholders 50 per cent of the premium collected.

This having worked in Rhode Island a member of the Massachusetts textile people came down and they studied Allen's method and they wanted him to bring the company up there. He said, no, organize your own mutual company, so the second of the factory mutual companies, the Boston Manufacturers were started by a group of textile manufacturers in Massachusetts, in the Boston area who wanted to do the same thing. At one time we had reached a point where

there were 27 factory mutual companies started across six States. Not all of them were in the textile field. When people in other businesses felt that the same basic idea might be applied they went out and organized a factory mutual for their industry. There was a pulp and paper mutual. There was a rubber manufacturers' mutual so that these companies -- they were also regionized.

There was the Philadelphia Manufacturers Mutual which is one of our continuing companies to this day. Out in Chicago the businessmen in industry in that area wanted to enjoy the same type of protection. They set up a Protection Mutual in Chicago.

My whole point is this, the mutual idea which originally started with residential properties could be applied just as much to industrial property but in applying, in starting up these factory mutual companies, Allen and his associates brought in an idea that was new even to the mutual companies and that was the idea of loss prevention, of doing everything possible to help the people who were members of this company to avoid loss. This has been the keystone in the factory mutual operation from the very beginning. Such success we have is founded on that without any doubt or question.

We are now in the midst of holding meetings of our policyholders across the North American Continent, as a matter of fact one just finished in Toronto a week ago, I believe, which we called the Fire Safety in Industry to which we invite our policyholders to

send people out of their plants to a school for one day. We originally used to set this up as a three-day course at our headquarters in Norwood. We found this to be restrictive on what we could do because people from Canada or from the western United States wouldn't send their people to the plant to Norwood.

We have taken this out to our policyholders. The whole purpose of this school is to try and help our policyholders to avoid loss. We have started in the last five years a programme we call property conservation. The whole idea of this is the need for giving emphasis to the human element of loss prevention. All the properties we insure are inspected by our own engineering staff who go through these plants and make recommendations to management with reference to changes which might be made in the physical plants. They recommend installation of sprinklers, for example, and where part of the plant is combustible they may recommend special protection like CO_2 protection with dip tanks or water spray protection for electrical transformers.

They will recommend dividing up a large area with a fire wall so if a fire should take place it will be limited in the territory in which it can spread and the degree to which it can do damage.

This is important, but we found that we were neglecting, or at least some of us, the human element and we came to the conclusion after some study of our loss experience that the most important thing in the good experience and the ability to

prevent loss is not necessarily the building and the protection which is built into it, automatic features to be added to the building, but the people who work in that building and we discovered that the only way you can throughout an organization have a feeling of real responsibility, of real concern is to have that concern first expressed by the guiding head of the enterprise, if it is the president or the managing director, whoever it is. We have based our whole campaign on first selling the top operating executive and then work down through the vice-presidents, down to the plant superintendents, down to the foremen, down to the last man at the lathe at the plant.

We have, for example in Quebec, because so many of our policyholders are French, we have printed some of our literature for the employees in French so that you can bring to them the importance from their standpoint as employees of being careful, of preventing fires. We think this is one of the keystones of the factory mutual approach. We think it is responsbile for the success.

We have found property owners everywhere, and I may say that this approach is much appreciated in Canada among the largest companies in Canada, and I say this not in boasting, but we are proud of them. Our members of the factory mutual companies secure their insurance and their loss prevention from us, people like the Aluminum Company of Canada, Canadaire, Iron Ore of Canada, Ontario Hydro and I could go on almost indefinitely. This $5-1/2 million in property

we insure in Canada is, I would say, almost entirely industrial and commercial property.

With the passage of time the number of factory mutual companies has declined, not through failure, we have never had a failure, we have never had a failure of a factory mutual, but their consolidation. This process will be going on. When I came with the Factory Mutual 17 years ago there were nine companies. There are only seven today because of mergers and re-insurance with within the group. I think ultimately there will be a smaller number.

We are coming more and more to think of the factory mutual as a single system. We have a single jointly-supported engineering department, for example. We have a single jointly-supported adjustment department. We have a single appraisal department. I am, of course, general counsel and head up the legal department which acts for all of the companies together. We have a single rating group. There is no question in my mind as time goes on there will be still further consolidation. There may be even new factory mutual companies because there is still a great deal of vitality in this system.

We just organized within the last year our first foreign subsidiary, the F.M. Insurance Company Mutual of London because we found that there is no equivalent in England and on the continent of the type running a prevention service which we offer to industry here in North America. We found that with the Continent there is a great need there. I can

visualize in the future that as our companies here in North America consolidate we may have other companies organized in other countries. There has been many discussions at one time or another of whether or not it would be desirable to have a Canadian mutual company. It is not impossible that it may be sometime in the future. Many of our companies have Canadian directors. We feel that our companies are not -- their home offices happen to be in the United States but we feel that they serve all their policyholders everywhere and we have appreciated the advice we get from our Canadian directors.

I had notice in reading some of the testimony of Mr. Hand both at the first and subsequent discussions you had it refers to what is a pure mutual and what isn't a pure mutual and I am somewhat amused by it.

PS We differ from many other mutual companies in that we have always insisted that one of the things that a mutual must watch as it becomes big is the contact with its policyholders, the feed-back from them, so that if you revue the Boards of Directors of our companies, you will find a minimum of professional management on the Board.

In other words, out of 15 directors there will only be two of the company's officers on the Board and the other thirteen directors will be men from our policyholders, men from industry, men who are used to dealing in large affairs and who regard these companies as their own.

I can say to you from our own knowledge of many proposals for further expansion of our service, for example, the organization of this new company in England, not a single one of our presidents would commit himself until he had a chance to talk to his Board of Directors. He had to make certain they felt that such an expansion outside of the North American Continent was in their interest and in the interests of other policyholders. We still have this direct contact. We try to maintain it in other ways as well because we think this is one of the problems. We do it through literature which is sent out to our policyholders every month. We do it through letters to them.

For example, we just decided a few weeks ago we would expand into the boiler and machinery field because we felt that it would be -- that loss

prevention is important and we could see the advantage of the consolidated engineering division which could handle both.

This was announced to all the policyholders before there was a word of it in the insurance press or anywhere else by a letter sent to each policyholder over the signature of the president of the company with whom he was insured.

Despite the large numbers, the half-billion dollars in assets, the ninety billion dollars in property insured, we still have fewer policyholders than many of the, let us say, cash mutuals here in Ontario. There are less than fifty thousand policyholders in the whole factory mutual system in the seven companies.

One of our companies calls attention to the fact that over half of its business is with corporations who have more than one hundred million dollars of insurance with them. In other words, it's at the exact end of the spectrum from the fire mutual who basically, in philosophic concept, does still very much the same. These are a group of property owners who have joined together so that they may, through a common enterprise, reduce the cost of their insurance, in the case of our companies, so that they may make available to each other services in loss prevention specialization which would not be available to them as individuals.

Some of the largest concerns in North America who, you would say, would be perfectly competent to set up their own engineering in loss prevention

service, for their own reasons turn to us.

Monday I was in Detroit talking on property conservation before a group brought together at the University of Michigan, representing Michigan industry. Most of the people there were from the automobile industry.

The automobile industry is, to a large degree, insured with us. We,for example, are the primary insurers for Chrysler. We carry half of the insurance for General Motors. We are primary insurers for Studebaker-Packard. We share the line on what used to be the Nash Company, now Rambler, American Motors so that throughout the automobile industry -- we used to have Ford in the United States. We have lost it in the United States, but we still have the insurance for Ford of Canada, curiously enough.

Now these people, some of the largest corporations in the world, could set up their own loss prevention system but they turned to us for this service because we could do it, they think, better. We can do it with a wider range of experience covering a wider range of industry. We can do it because we can afford specialists to a degree that even they couldn't,and, last of all, there is always an advantage in this area of having an outside independent opinion, which is not perhaps influenced by a desire to please management.

This, I think, is the story of the factory mutual. It has been a successful operation. As a result, our seven companies now have a surplus -- I believe the

smallest one has over $10 million in surplus. The combined surpluses of the companies are over $300 million. We have, we hope, constructive plans for the future. As I say, we can see an expansion of this idea into the rest of the world with the growth of industry across the world. We can see some expansion in other types of coverage. This, of course, is already underway. When we started out, we insured fire insurance. This was what Mr. Allen wanted. This is what he would have had to pay $2 for. Over the years we have gradually broadened in the scope of our coverage until now we not only insure most fires, but we insure wind storm, explosion, sprinkler leakage, riots, civil commotion and malicious mischief, motor vehicle damage, aircraft damage, sonic boom damage, smoke damage, loss from molten metal. All these things have been using the same basic premium deposit.

In other words, we did not increase the rates as we added these perils because out of the premium deposit we could take the loss and the expense we have in connection with such additional coverage so that now at a much lower rate than we used to a hundred years ago we are giving coverage of almost all of the normal perils.

We have under study in our committees a possible future expansion -- we are considering giving our policyholders insurance against all risks of physical loss or damage. This we run into trouble with. You have some perils which are not uniform across all of the policyholders you insure. Let me now give you only

two of them: earthquake and flooding which are quite likely to be limited geographically to an area now should you ask our policyholders to absorb the losses you have from an earthquake? Now that they do not have a common experience, you may do so, but if you are going to do that, then you should adjust your rate level to take into account the fact that some of the risks are more exposed to loss than others.

In this area our problem is to deal equitably between our policyholders. Sometimes it is quite difficult to work out the technical problems when moving into areas in which you do not have experience. We do not follow the same rates as other insuring companies. We use this premium deposit plan in which the amount put up by the policyholders is the same whether the policy is written for a period of one year or three years or five years and if he cancels it in mid-term, we have no problem on the adjustment because, for practical purposes, we deduct from the premium deposit for the period of time his policy was in force.

If he wrote a five-year policy, he pays the same premium deposit as he would if he wrote a one-year policy and if he cancels that policy at the end of one year, the cost under it is exactly the same as the cost would have been to a man who took an annual policy in the first place.

We do this by having what we call a monthly absorption. We try to keep track of our losses and expenses. I suppose with modern electronic equipment

now we will ultimately come to the point where we can make a daily absorption, but at the time we set this up, the simplest unit for accounting purposes was the month, and you could determine the loss and expense for the month and you, therefore, can in a sense charge the premium deposit for this loss and expense. Now we quickly discovered that business would rather have us absorb the small fluctuations from month to month than having a charge which was made down to three decimal points.

At the moment, based on our experience, and it has been fairly consistent for a period of time now, we make a monthly absorption of one per cent on the whole of our premium deposit for each of our individual companies, less its own business. There is no common system on this absorption, and in old companies, like a manufacturers' mutual, it has perhaps larger investment income than some of the younger companies and it has, as a result, higher returns to its policyholders. The experience of our companies will not be absolutely uniform. Even though they share in each others risks, they do not do so in any uniform agreed percentage and any one of our companies is perfectly free to refuse to participate in a line written by another company and this being a real world, we have differences of opinion amongst our executive as to whether a risk is or is not a good risk if insured at this rate, so that we do not have a uniform experience. I think this shows up very clearly in the income tax we pay.

In 1962 three factory mutual companies paid income tax in Canada. Four did not. This represented a difference in the experience of these companies in Canada so that it is, I think, an unique I know of no equivalent in the world in some of the things we do. This premium deposit system and, of course, the idea of loss prevention is something which is now adopted and followed by many other insurers besides us. It is followed in the casualty field and by other companies in the fire field. I think that we still have the reputation, internationally, of having not only the best-trained and qualified staff but having the physical facilities which are not available to anyone else in the group insurance field.

We have what I believe the only privately-owned true research laboratory working in the field of loss prevention.

I am familiar with the laboratory maintained by many of the other insuring organizations and applaud the good work they do but, by and large, their task is to test equipment. It is to try and examine and they do some work in the field of electrical equipment, extinguishers, spinklers, and so on but we actually are, I think, the only organization that I know of in this area which has research scientists on our staff whose job is not to test equipment but to examine the fundamental chemistry and physics of combustion; to try and think about the problems of loss prevention on a wider area to see whether there are new approaches.

We are getting into ruts; getting used to the idea water is a fine extinguisher and the sprinkler system is a fine way of bringing water to a fire. It turns on automatically and puts the fire out but we know that it is not necessarily the perfect answer. We are very concerned, for example, over the fact that a small fire may open a sprinkler head and the sprinkler head would put out the fire but if you do not have the necessary machinery to check the fact that the sprinkler has operated, you may have thousands of dollars in water damage from continued operation of that sprinker.. We would like to find, and we have men working on the problem, a sprinkler-head that will turn itself on when the fire starts and turn itself off when the fire is out and it will still be economical to produce.

The technical problem is easy. Our engineers can produce such a system. Only one problem: no one could afford to put it in their plant.

We are doing original research in chemistry and in physics, in the basic problems of loss prevention and this is not done, as far as I know, by anyone else. It is paid for by our policyholders and since they, in their own enterprise, are convinced of the need for research -- our largest single policyholder, for example, is General Electric Company. When I consider the millions that they spend on research every year, I can understand the willingness of John Lockland, who sits on one of our Boards of Directors, to support research on our part but these are things we do.

I noticed in Mr. Ham's submission to you, he emphasized the fact we are big business. You shouldn't confuse these people with the little farm mutual because this is an organization set up by industry to serve industry.

My whole point in these remarks is to try and illustrate that the basic mutual principle of sharing losses among a group of people who have relatively the same loss exposure, of joining together so that they can have available to themselves common facilities for research, for engineering, for expansions, for adjustment, these things which you see in the small farm mutual can be done just as well in the very largest company and I hope that at some future time when our companies have well over one billion dollars in assets, properties insured, well over one hundred billion dollars in property, we will still maintain, as we have with other one hundred thousand dollar policies which we have, some of the fundamental principles of mutual insurance; of determination of cost on the basis of loss and expenses during the period the policyholder was a member of the company.

The development of an organization which can act for all of the policyholders in loss prevention and serve them in the event that they do have a loss, and we think that the fact that our policyholders are big does not prevent these same principles from operating with great effectiveness.

That is a rather long answer to your question Mr. Carter.

THE CHAIRMAN: It is a very complete one indeed. You certainly told the story of the factory mutual very well Mr. Kelly. We have no doubt that they are rendering extremely valuable service to industry and to Canadian industry.

This is a Tax Commission and we have got to get to the basis on which you are taxed, the difference between taxation to you, because it is our job to see that all citizens, corporate or otherwise, bear a fair share of the burdens of our Government.

Before I get to that, is there any question up here with regard to what Mr. Kelly told us? If not, I would like to proceed with the financial statements. I think you told us that very completely.

Now I am not entirely clear with the way on which taxation is applied to the factory mutual here by seventy-four, that return premiums are deductible before arriving at taxable income. I have before me a financial statement of the Manufacturing Mutual. I see it comes down to a net operating balance, this is called for 1962, of $1,394,000. That is after having paid Federal income tax of $936,000, so that there would be $2,300,000 of income before taxes and it would look to me as though that were approximately the taxable income upon which the $936,000 was paid.

MR. KELLY: The statement you have, of course, covers both the United States and Canada Mr. Carter.

THE CHAIRMAN: That is right.

MR. KELLY: We are in the interesting position, I mention this in my brief filed with you, that the

American law was changed only last year, and we will be on a different basis of taxation for the year 1963 than for the year 1962.

Originally when the Income Tax Act was adopted in the United States, it was regarded as a tax on profit and everyone in the mutual companies field pointed out, rather vigorously, that mutual companies did not make a profit. They were not in the business to make a profit and, therefore, they should not be subject to taxation.

This point of view was accepted in the United States in the early days of the Income Tax Act and the mutual insurance companies paid no taxes. However, in the war years, and I mean the second world war, the point which you have just made was strongly emphasized: the fact that these, in the last analysis, were business enterprises and that they should bear their share of the cost of financing Government and provide for its defence.

Congress at that time in the United States decided to tax mutual insurance companies but in view of the long argument over whether or not they made a profit, or not, they decided that it would not tax them on profit but would set up a rather complex formula in the alternative under which mutual insurance companies either paid tax at the regular income tax rate on their investment income, or paid a tax of 10 per cent of their gross receipts, whichever turned out to be the smaller and they set out a formula for the calculation of such gross receipts. In the case of

factory mutual companies, because of our premium
deposit system and our, therefore, high investment
income, and we do hot bury the dollars our policy-
holders give us in the backyard. We put them into
securities, Because of our high investment income, we
always paid a tax on our investment income and we
quickly discovered that the effect of this was that
in the years of very adverse loss experience, we con-
3 tinued to pay the same income tax that we pay in
years of very good underwriting experience.

In other words, this tax on investment
income went on constantly and it was just the same,
whether the results, the operating results of the
year were good or bad. In Canada, where I think you
showed more discrimination, the foreign mutual companies
were taxed basically on the same method and plan as
stock insurance companies but you did recognize,
in section 74, the basic reasons for my being here;
what I think is an absolutely sound principle, that with
the return of premium by any insured, and I am not (page
4964 follows.)

just arguing for mutuals, but these policyholders should be deducted from the premium income before you calculate the operating results of the company. The whole point of these remarks, Mr. Carter, is that of the $900,000 paid by the Manufactuers Mutual the bulk of it or almost all of it was paid as a tax on investment profits in the United States. In that year the Manufacturers Mutual because of heavy Canadian losses paid no income tax in Canada.

The United States Congress changed the law at the last session. For 1963 and in future years the mutual companies will be taxed in the United States as they are now in Canada. We will be taxed on our operating results. 1963 happens, for the fire insurance business, to be generally a year of very poor experience. We have suffered very heavy loss in 1963. Our companies will pay no income tax in the United States. I think we will pay one in Canada because our Canadian experience has in general been much better than was our experience in the United States.

The last point I would make then in the change in the United States law the principle which you have in Section 74 is recognized and the return of premium to the policyholder either in cash or credit to him against any charge for future insurance is recognized as a proper deduction from income and we therefore have both in the United States and Canada a situation in which the mutual insurance companies are paying their share of taxes. The only difference in it is not made on the basis of mutual or stock --

you can have a participating stock insurance company and it gets the same benefit. Any returns of premiums made to policyholders which reduce the policyholder's cost is taken from the premium before you have a calculation of profit.

THE CHAIRMAN: Perhaps that will explain a point that now puzzles me. It would seem to me that if this company whose statement is before me operated on the basis of exact cost that its returned premiums would be such as to bring down net premiums to its cost of operations, its net operating balance before income tax would be equal to its income from dividends and interest but it isn't. Its income from dividends and interest is $3,175,566 and income before taxes is $2,321,000 and therefore it has lost some of the income from dividends and interest in addition to make any profit. Why would that happen?

MR. KELLY: This is always going to happen in our system. With the change in the law in the United States what is going to happen is this: In every year our losses and expenditures will always be more than the amount we take from the premium deposit. For this reason we give policyholder credit for the investment earnings. In other words we don't pull these investment earnings back into the surplus so they will build up indefinitely. Our practice is to total our losses and expenditures for any period, deduct the investment income which could be allocated to that same period and then they have income which needs to be absorbed from the premium deposits if they

are to have exact balance. The last point we have, having in mind income for future expansion and also a reserve against catastrophic. In our type of operation I need hardly say a catastrophic loss is much more common than with a dwelling house mutual. They will hold out an additional amount as catastrophe reserve. In the case of some companies this is done on a purely accoutning basis which I like in that they set this up as a separate reserve and change against it whenever they have losses over a certain size.

In other companies it is not formalized to that degree but they put practically the same amount into the surplus over and above the amount needed for normal operation. In other words they take from the premium deposit more than they need to pay the difference between losses and expenses and the investment earnings to cushion the shock of a catastrophe loss. Under this system the largest single loss we are able to pay in one fire at one location is $14 million. We underwrite against property in one location a maximum of $30 million.

Our re-insurance is arranged so we accept the fir $10 million of loss ourselves in the Factory Mutual system before we call on our re-insurers. They pay up to 90 per cent up to $52 million. We need capacity of this kind because industry in the United States and Canada is producing risks which have such loss exposures. You couldn't possibly ask the policyholder in Canada to absorb such a $10 million blow. You need to have machinery for charging this against surpluses,

for spreading it over a period.

THE CHAIRMAN: That hasn't influenced my understanding of this statement. I take it I missed one point. I think I am assuming from your reply to my last question, Mr. Kelly, that the net operating balance of this particular company here is not really a profit or a loss. It is, in fact, an amount which has to be set aside against catastrophe; is that correct?

MR. KELLY: That is correct.

THE CHAIRMAN: It isn't the residual left over as between losses and expenditures . . .

MR. KELLY: That is correct.

THE CHAIRMAN: It is a calculated amount.

MR. KELLY: That is correct.

THE CHAIRMAN: So that really a different way of stating this, and I would suggest a very good way might be to show this as provision against catastrophe and come down to a nil balance.

MR. KELLY: I think that this is a way which would probably lead to clear reading of the statement. Our accountants have been doing it in this way for many years and I would be quite happy to discuss it with them.

THE CHAIRMAN: It is all right as long as I understand what it is. The unassigned surplus in this case which is $72,672,000 which has been built up out of this balance I am referring to and also out of the security transactions is really a provision against catastrophe.

MR. KELLY: There is one last element in that unassigned surplus and this gets down into insurance company accounting. Our companies put up premium deposit on interest yearly which is the same regardless of the term for which the policy is written and at the same time on anulled policies we are returning actually 88 per cent so if a man insured with us for one year, puts up $100,000 as a premium deposit and cancels his insurance at the end of the year he will receive $88,000 back in cash. Now, we get short cycles in insurance accounting which accepts this surplus figure and which may inflate that somewhat. In insurance accounting if we write an annual policy we set up a reserve, and this is true both in the United States and Canada of 50 per cent of that because this goes back to the theory applied to all insurance companies that the premium is earned over a period of years and that on the average if you take on policies written for one year 50 per cent of them, you will have 50 per cent to run.

You set up a reserve of 50 per cent of the premium. We are asked by all the Insurance Departments, they insist, to set our books in the same way so that of this $100 thousand premium deposit we set up unearned premium reserve of $50 thousand. We have had expenses in connection with the writing of the policy which will probably run into $2 or $3 thousand and we then have a book entry transfer to surplus of the difference between the $100 thousand and $50 thousand, irrespective of the loss reserve we may have on that

contract and our actual out-of-pocket expenses. The surpluses of the factory mutual companies which you see on statements similar to that is an element of overpayment or rather understatement, whatever you want to think, of unearned premium reserves which are used up in setting up the surplus are really far more than the amount we will need, that we will ultimately return a part of our surplus represents this difference between the unearned premium reserve and the amount that would ultimately go back to the policyholder.

This is an involved point and I am afraid I am not making it entirely clear. In my original example of $100 thousand premium deposit written on a policy, let us say in May of any year, at the end of the year will have a reserve of unearned premium of $50 thousand only. We will have had actual expenses. We will have had a small loan reserve we may have charged against it and we will have a very substantial amount which from a bookkeeping standpoint is a transfer to surplus. When the policy expires $88 thousand is going back to the policyholder. The premium deposit system, and this is a point which Mr. Ham also mentioned, it represents a contribution by our policyholders to our working capital -- it represents a substantial part of the surplus which you see there. Of a reserve like this, Mr. Carter, which is based on the actual rate of return being made to ourpolicyholders we find that our surplus would be reduced at the present time about 30 per cent.

THE CHAIRMAN: It is no business of mine to criticize your accounting, but I would think it would be much easier to understand if your deposits were brought into a deposit account until earned and then taken out of the deposit account and put in income and balanced. This is fundamental accounting philosophy.

MR. KELLY: That is true. It is not fundamental in this area of the insurance business, and as far as we are concerned there is one very practical reason why we are against it. Under the insurance Statutes that most of the United States, although I don't believe they have similar provisions in Canada, the maximum liability that the company can take on any particular risk is 10 per cent of its surplus. If we set up our accounts in the manner in which you suggest this wouldn't be in surplus, it would be an escrow account.

THE CHAIRMAN: I think that is the basis of what I had to say. I don't think it is surplus.

MR. KELLY: Therefore it couldn't be used as a base for underwriting and we wouldn't be able to provide insurance to large industrial risks we had. I think our accountants would agree with you, Mr. Carter, fundamentally it is an escrow account and we, in our figures, always are careful to keep track of the difference between what we call our liquidating surplus which is surplus we would have if we returned to policyholders at the present rates funds they have on deposit with us and our Statutory surplus.

THE CHAIRMAN: The company I am looking at

has $110 million in total surplus of which $37 million is what you call statutory surplus and $72 million is what is called unassigned surplus and there is a little guarantee fund of three-quarters of a million dollars.

MR. KELLY: We have to set up that guarantee fund in order to meet requirements. It makes no sense to us to sink part of our surplus, about $500 thousand in a guarantee fund, but at the time when we were asking for power to write additional lines of insurance two States required us to put up a guarantee fund and said it was required under their statutes.

THE CHAIRMAN: I understand.

COMMISSIONER WALLS: I would like to ask one thing with regard to your disaster reserve or catastrophe reserve you withhold from the policyholders. Do I understand that in four of the companies or three of the companies that that reserve was set up in relation to the total amount of insurance coverage, that there was a relationship?

MR. KELLY: No, they haven't set it up on that basis, Mr. Walls. It might make more sense if they did, but they haven't. What they have done is that, and this is only done recently, from an accounting standpoint within the last five years, in order to set up a catastrophe reserve in those months where they had no catastrophic losses they transferred one per cent of their earnings into this catastrophe fund. In those cases which they would refer to as catastrophic losses they charge the fund rather than making a charge against the operating results of the month. This isn't a percentage

of their insurance in force. I think at some time in the future -- there are all kinds of arguments as to how much surplus a mutual company needs to cover a catastrophe situation. At the moment our companies are exposed in a single loss to $10 million in the first loss retention plus 10 per cent. Consider a loss in any location of $30 million, 10 per cent of $20 million which would be $2 million so $12 million -- we feel our companies could absorb $12 million loss without undue loss of sleep, let me say.

What continually nags us in the back of our minds is if we should have a widespread catastrophe where a hurricane, or the one that bothers us is an earthquake on the Pacific Coast with a subsequent fire similar to the San Francisco fire of 1906 where we could get several large locations and get accumulation which could run beyond the $12 million, which we are perfectly willing to accept, to perhaps as much as $25 or $30 million.

We are very conscious of the fact that when we recover money from our re-insurers they expect it to be repaid over a period of years. We have discussed this with our re-insurers and there is a general understanding that in the event of any recovery from us we must enlarge our rates for re-insurance and pay them back over a period of approximately ten years. We have tried to do some calculations as to how much re-insurance costs would be increased by the need of meeting these larger payments for re-insurance. That is the reason for the loss clause, the check on the

amount of insurance that we write.

On this 10 per cent of surplus, 10 per cent of Statutory surplus we could theoretically meet losses ourselves of $30 million. We are holding ourselves down. If we have a loss of $30 million at one location it will only cost us $12 from our surplus. We have such a margin. It is quite conservative underwriting. We can visualize a situation in which we will have two or three losses at the same time.

We sometimes think with the day and the age state conflagration is possible. We are continually being reminded of the fact we could have a critical situation over a large area of the country in which with high winds and high temperature you could get an outbreak of fire in many States. We had such a situation in April of last year when there was a loss in insurance business of $30 thousand in a fire running from Virginia up to Maine. One of these net a industrial plants, I am happy to say not insured by us. The loss of that plant was $40 million. This was exposure fire damage communicated in this fashion, very similar to that in Chicago, the great Chicago fire in 1872.

In remember we had a New England forest fire almost ten years ago where they burned over a large area of the country and at one time we were concerned because there were a number of fires on the outskirts of Bidiford and Saco where we had insured a couple of textile mills and one large firm making textile machinery who had plants in these towns.

We remember that one of our large losses in the past was the Naumkaeg Mill, Salem which was burned in the fire of Salem Virginia in 1912. All these things are changing. Conditions are not necessarily going to be the same in 1970 or 1965. We may reach a point in our own discussions, and we have given this some thought.

We feel if we reach a point where we have a surplus in the factory mutual system of $5 million this would give us adequate funds for carrying on the underwriting of industry and we wouldn't need to go beyond that. That would also give us adequate funds to handle any possible catastrophe we could possibly foresee. When we reach that point if we follow through on our present thinking there would be some increase in our return to our policyholders because we wouldn't feel we needed to pile up. Any mutual company, if they pile up surplus indefinitely -- with a mutual company in the United States such as Philadelphia Contributorship for insurance of loss, houses against loss by fire -- my point is this company over the years has now a surplus which is so large that the investment earnings on that surplus pay all of the losses and expenses of the company and provide almost $1 million in surplus each year. If this monster is not stopped it will own the whole of Philadelphia.

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RPS

And that company, this is the perpetual mutual, you actually get your insurance for free with a return on top of it. If you insured a house inthe Philadelphia Contributionship, you pay one premium. If you cancel your insurance inthe first year, they make a penalty against you for cancellation but if you leave the insurance more than three years, you can at any time cancel and get your premiums back anytime. If you continue on with them, they pay you a return of 10 per cent of your premiums during all the time that the insurance stays in effect and they still can't keep the surplus from accumulating.

COMMISSIONER WALLS: The reason I asked my initial question was if there is no limitation placed on these funds for which you continue to ask your policyholders to contribute towards the reserve, then, in effect, is it not becoming a fund used for expansion rather than a fund for disasters?

MR. KELLY: There is no question, for example, in my mind that the funds which we have accumulated have, to some degree, been used for expansion. This new English company that we have set up is being set up with funds which were accumulated out of the prior year's operation. As long as this expansion is within the basic purpose of the company, I cannot see that there is anything wrong with it.

In other words, we start with funds from fire insurance alone. Now we are using those same funds to provide insurance against such additional perils as windstorm, explosion, riots, and so on.

We are now moving into the boiler and machinery field. We are financing this expansion, and I don't want to give you the impression that we are not, with funds which have been built up over the years out of our property insurance business. We think that this is such a related area, and that this was only done with the approval of the Directors of our companies, that it is such a related area in this loss prevention aspect, that we could function effectively for them, and that we could -- they all own boilers and process vessels and machinery of one kind or another, that we could move this basic idea into a wider area.

We started in the textile field, Mr. Walls, and we decided, with some reluctance on the part of our largest policyholders, to move out of the textile business. It is fortunate we did so because if we had stayed in it, the New England textile business, I am sorry to say, is dying on the vine. We would have died with it. Now the largest single industrial class that we have is metal working.

THE CHAIRMAN: It's only so long as you put money into these funds, or you accumulate it in these reserves that you pay taxes?

MR. KELLY: That is correct. Now as the law is set up, whenever we accumulate money in reserve, we pay tax on them.

COMMISSIONER GRANT: Mr. Kelly, this premium deposit system which you use is, I judge, a payment by the insured and it can be as high as 88 per

cent in the first year above the actual premium which he is charged?

MR. KELLY: This is at the moment.

COMMISSIONER GRANT: Take your example of $100 thousand. The insured pays into you $100 thousand, which is his premium. That is his premium deposit?

MR. KELLY: Yes.

COMMISSIONER GRANT: To cover his risk?

MR. KELLY: Yes.

COMMISSIONER GRANT: And you determined that that will be the amount. His risk could be $10 million?

MR. KELLY: Yes.

COMMISSIONER GRANT: Now each year that he stays with you then, that $100 thousand is deducted by the amount of his premium is it?

MR. KELLY: Well what we do -- yes, if he stays with us. If we write a policy for one year, we do the accounting at the end of that year. We send him a new bill for $100 thousand, showing a credit against that $100 thousand of $88 thousand. That is his deposit, so that he owes us $12 thousand to bring the $100 thousand up to that point again.

If the policy was written for three years, we would not bill him at all until the end of the third year. Then at the end of the third year, we would give him a bill, if he wanted to renew it, saying that $36 thousand of that had been absorbed and he now needs to restore $36 thousand to continue his insurance.

COMMISSIONER GRANT: Now then, of that money that is on deposit with you, does it find its way

into an investment account?

MR. KELLY: It finds its way into investments. In other words, all of this money is invested. We do not set up an investment account itself.

COMMISSIONER GRANT: The factory mutual then takes the increment from that into its revenue account?

MR. KELLY: Yes.

THE CHAIRMAN: And credits the insured's account?

MR. KELLY: Yes. We don't credit an individual insured. What we do is take the total investment income.

COMMISSIONER GRANT: But the fact is that the insured is deprived of the use of his $88 thousand for that year?

MR. KELLY: Yes.

COMMISSIONER GRANT: And the interest which he might have received on it. Now then in Canada you have about $22 million invested here. It that under the requirements of the Department of Insurance?

MR. KELLY: A substantial part of it is. I would not say that all of it is because our companies have, in Canada, perhaps a couple of million dollars more than they need in order to meet the Canadian requirements but the Dominion Insurance Department reviews the figures of our companies and as we have grown in Canada, the amount which must be on deposit has gone up steadily.

COMMISSIONER GRANT: When you say that you

pay tax on your investment income, I understand that you say that you do pay tax on your investment income.

MR. KELLY: In the United States until the year 1963 they called it an income tax but it was really a tax at the income tax rates on our investment income.

COMMISSIONER GRANT: Let us see what happens in Canada. Does your account permit you to make a return to the Canadian Government showing what your investment income is?

MR. KELLY: No. Here I would really need the help of some of our accountants but it is my understanding that in Canada they are not taking into account anything but investment accounts. They are not taking into account any of our home office expenses.

In other words, this is a rather unusual situation which was worked out when the law was passed, and it is true not uniquely for us, but for all of the companies from the States, and we are not permitted in calculating our expenses, to include any United States expenses at all. In the case of some of our companies which do not maintain Canadian offices, practically all of our expenses are United States expenses.

When I say we do not maintain Canadian offices, we have a Canadian head agent, no sales staff, no company employees, aside from the one man who is designated as Canadian head agent in Canada and their companies are not permitted to deduct any of their expenses whatever in calculation of income tax. It is

felt that the two items balance against each other.

I had occasion to talk to Mr. McGregor about this in the Dominion Insurance Department, and there is always some question as to whether you get complete equity in the case of any individual company, but it's really valid for us and everyone else.

COMMISSIONER GRANT: Then under your system, you have half a billion dollars coverage in Canada now?

MR. KELLY: Yes, $5-1/2 billion in coverage.

COMMISSIONER GRANT: $5-1/2 billion?

MR. KELLY: Yes.

COMMISSIONER GRANT: And your total coverage in Canada and the U.S. is $90 billion?

MR. KELLY: Yes, roughly $90 billion.

COMMISSIONER MILNE: I have just one question I wanted to ask you Mr. Kelly related to Mr. Grant's question, before you leave this particular point and it is in respect to the example that you gave where the insured is writing a policy for a three-year term. You suggest that his absorption of premium in that time might be 36 per cent?

MR. KELLY: Yes.

COMMISSIONER MILNE: Now really what I wanted to know was is the credit, or the absorption done annually or is it a three-year term in his case?

MR. KELLY: We will give him, if he asks, and quite often -- and this is a matter of corporate accounting -- the treasurer of an insured company will ask how much of the absorption should they charge against

the year, and we will then give him an annual figure, even though the policy still has not expired.

Technically, however, and now I have to put 2 on my legal hat, if we should have a catastrophe in the last month in which such a three-year policy was in force, and the directors felt it was necessary to change the rate of return on a three-year policy, they could deduct more from him. Now you can either say throw it all against the last month, or throw it back and level it over the years but if we suffer a catastrophe in the last month, he might end up with a return not of 74 per cent but a return, let us say, of only 70 per cent.

Now if he is charged, and those of our policyholders who can get these figures would have charged 12 per cent the first year, 12 per cent the second year, and then have charged all of it against the last year, he doesn't get the money.

We have some small differences of opinion again in our companies. One of our companies follows the plan which you suggest, and which I think is a very right one of giving him a flat charge in that period of time which cannot be upset by charges in subsequent months. Some of the others, however, maintain the legal freedom to change the rate of return on those three years, even in the last month.

COMMISSIONER MILNE: Thank you.

COMMISSIONER PERRY: Are there any issues involved in allocating taxable profit of these basically international operations to Canada, or is it simply on

the basis of the locus of the insured property?

MR. KELLY: Aside from this question which, as I say, involves the charging of our home office expenses, and the investment income on our Canadian investments, the tax laws in various countries pretty much let each country stand on its own feet.

Our taxes in Canada are not affected by the taxes we pay in the United States but our taxes in the United States are definitely affected by the taxes we pay in Canada. We are entitled to take credit, in our United States taxes, for the taxes we paid in Canada because we have to give the United States authorities a final summary of our overall operation and, therefore, we are entitled to deduct, in computing our taxes to them, the taxes which we have paid in Canada and I assume as we move into other countries we are in the interesting position -- and this was the one reason we set up a subsidiary to carry on our operations in England. We wanted to get away from these tax complication which we felt would follow from our bringing a new company into various countries.

COMMISSIONER PERRY: Returning to the American change, you mentioned that the old tax on investment income was an alternative to what sounded like gross premium tax.

MR. KELLY: Gross receipts tax.

COMMISSIONER PERRY: Was that dropped in the change?

MR. KELLY: Yes, it was.

COMMISSIONER PERRY: You do, though, pay a

State tax don't you?

MR. KELLY: We pay State taxes on premiums. This is true both in the United States and Canada, and we pay exactly the same rate as all other insurers.

One point I would make, because it is involved in our basic disagreement with Mr. Ham over Section 74, is that those State taxes, both in the United States and Canada, are applied on our net premiums after we have deducted the returns to the policyholders. In other words, for the purpose of State taxes, we are permitted to deduct these returns to the policyholders in determining the premiums against which tax is paid.

The States and Canada, the Provinces have all recognized that the true premium is the final amount paid by the policyholder net, after taking credit for the returns made to him.

COMMISSIONER PERRY: One other point: how are your policyholders treated in their tax returns in respect to the premium that they, or the amount they turn over to you in the first instance?

MR. KELLY: In this case, and this has been discussed, as a matter of fact, at the United States Treasury -- I don't know the Canadian side of this picture, but I do know the United States side, the United States Internal Revenue Service insisted that if they charge the premium deposit as an expense, they must then take in as income the amount we return to them.

The Internal Revenue Service prefers the

situation in which they charge it by the year but they can do it the other way. They are only entitled to deduct, as an expense for insurance the net which their insurance has cost them. They must take in as income, if they have deducted the whole thing as an expense, the returns from us.

THE CHAIRMAN: That, I believe, is true in Canada.

MR. KELLY: I think so. I am not sure.

THE CHAIRMAN: I have seen it quite often.

COMMISSIONER PERRY: Thank you.

THE CHAIRMAN: One matter I would like to be very clear on is my understanding of the basis on which your company pay Canadian taxes. It would seem to me that in view of what you have told us, and Section 74 of the Act, they pay taxes on the amount that is decided by the Directors shall be set aside as a catastrophe provision, or should be carried into the unassigned surplus. That is not anything which results from the operation. It is something which comes about solely as a matter of the judgment of the Directors. Am I correct?

MR. KELLY: In the last analysis, this is correct and this was the point which was of some concern to the people in the United States Treasury when they were considering that change in the law.

They contended, at one time in a discussion in which I participated, that our companies by changing their rate of return could, if they wished, eliminate taxes.

THE CHAIRMAN: And in fact taxes will disappear if your companies ever reach $500 million of reserve?

MR. KELLY: If we reach a point where we have sufficient surplus and are providing insurance exactly at cost ---

THE CHAIRMAN: You would pay no further taxes.

MR. KELLY: We would pay no further taxes, this is true. If we were operating a stock insurance company, and we had sufficient judgment or wide enough spread of risks so we could do this, so that we could set our premium levels every year at the point where they provided us enough income, plus our investment income to pay our losses and expenses, we wouldn't pay any taxes either.

The problem in doing this, it is much easier to do it in retrospect when you know what your losses and expenses are, than it is to do it in trying to establish the premium rate for the future, but if we ever reached the point, Mr. Chairman you are correct, where we had the surplus we felt we needed to carry on the business of our companies, and we then set our return so that it would cover our investment income, plus the absorption, just equal our loss and expenses, we would pay no taxes.

COMMISSIONER PERRY: This is the ultimate in mutuality isn't it?

MR. KELLY: Well it can be so argued, Mr. Perry. We do not anticipate any such condition in

the near future, I might say. We felt that with the need for more and more investment, we will need to continue to grow and we did our best, apparently successfully, to explain to the Ways and Means Committee, and it has the technical staff, from the standpoint of the need for provision against catastrophe and expansion.

They can anticipate taxes from us for quite a few years as we continue to build our surplus accounts.

THE CHAIRMAN: Any questions? Mr. Kelly, you have made it very clear to us today. Thank you very much for appearing today and your excellent submission and very helpful answers. We have enjoyed having you.

We will stand over 10 minutes.

---A SHORT RECESS.

---FOLLOWING THE SHORT RECESS:

THE SECRETARY: Mr. Chairman and Commissioners, the next brief is being presented by Mr. W.M. Anderson. Mr. Anderson is here to speak to his brief which I now enter into the record as Exhibit 246.

---EXHIBIT NO. 246: Submission of Mr. W.M. Anderson.

SUBMISSION OF
MR. W. M. ANDERSON

Appearances: Mr. W.M. Anderson.

THE CHAIRMAN: Thank you. Good morning Mr. Anderson.

MR. ANDERSON: Good morning.

THE CHAIRMAN: Please feel relaxed. We would like to conduct this in as an informal a manner as is consistent with getting a record. I must confess I have had a little difficulty explaining your paper

to my colleagues. Some of them are a little slow. I have been making full use of the dictionary and so on, but there are a number of matters that I think you have thought about more than anybody else of whom I am aware. I would like to address myself to these particular points.

Some will coincide with your paper and some will not. I know they are in the areas of your interest. Before I do address myself to questions would you like to say anything to us?

MR. ANDERSON: Mr. Chairman, I would like to thank you for what really is an invitation to appear before this Commission. Perhaps without the invitation I might not have come forth. I may have contented myself to assist other presentations of briefs.

In accepting the invitation I think I made it rather clear I wasn't appearing in any sense of the word in relation to the life insurance business. I don't propose to make any comments about taxation as it affects life insurance nor do I expect to answer any questions on that subject.

The other point I would like to make, Mr. Chairman, is that I am rather apologetic for the material which I was able to file in the sense that it embraces an important part of my thinking but it hasn't touched explicitly on some of the other areas that are connected with the whole form of the indirect tax system and also the appropriate level of indirect taxes in relation to Government

activities in the way of expenditures and business services. It doesn't touch certain of the points that are implicit in the theory. One to the effect that the so-called direct tax on income including the tax on undistributed corporate profits should be in balance with the Government transfer payment programme; in other words that the direct taxes should not be revenue producing instruments but rather redistributional instruments.

This, of course, also implies another point, that according to the theory the tax rate at any one time on undistributed corporate taxes would be the same as the maximum tax rates on individual incomes. In other words undistributed corporated profits would be regarded as income not yet identified with individuals. By reason of this failure to identify there would be no consumption function attached to undistributed corporate profits.

I think those are the only points I wanted to make. I would be very happy to try to answer any of your difficulties with the dictionary. I must confess that on reading the material, there are a couple of words I have used myself where I am not sure I used the right sense. I think I have used the adjective "imputed" where the word should probably be "assumed" or "presumed".

THE CHAIRMAN: As a preliminary to any further questions, any further discussions, you have distinguished between taxation of distributed and undistributed corporate incomes. I think you have done that because you believe that the incidence of the two

are entirely different. If that is so would you tell us why you distinguish between taxation of distributed and undistributed corporate income?

MR. ANDERSON: Undistributed income is something that is held at the level of the corporation by reason of decisions taken by the corporation.

In the alternative it could be distributed and would arrive in the hands of the shareholders. It doesn't seem to me that the Government should accept these decisions where its current revenue position is affected by reason of the decisions. Government should in effect say "If you want to hold profits back pay tax on them and when you want to distribute them recover the tax."

I don't think the Government revenue system should be influenced in its incidence by the complex of decisions that are taken as to holding back corporate profits rather than distributing. I think if I may say so that attitude agrees with the view of Simon Kuznetz and others who have expounded that the well-being of a community is not in general well served if there is a large amount of retained profit at the corporate level. It is preferable in a progressive industrialized society for profits to move out to the level of the owners of savings and if these profits do come back into productive enterprise it should be through the free capital market rather than having them earmarked at the level of the individual business.

THE CHAIRMAN: You suggest that the revenue system should not be effected by decisions arbitrarily made by directors as to how much of their income is distributed and how much is not distributed.

MR. ANDERSON: More generally in a practical sense if retained earnings are normal occurrence, the failure to apply income tax to them means that the Government is involved in a time lag in the collection of taxes.

THE CHAIRMAN: In the past we have had revenues affected by these decisions because tax on undistributed income has been applied at the time it was distributed. Would you suggest to the extent that undistributed income is taxed differently from distributed income, and it has been in the past, that that tax on undistributed income be levied at the time the income is created and not when the income is distributed.

MR. ANDERSON: My feeling is that taxes on undistributed income should be levied as a profit tax in lieu of personal income tax. It should be levied at the time income is earned. The corollary, of course, is recovery at the level of the corporation, at the time the income is distributed.

If the corporation suffers a reduction of surplus it will in part recover by reason of the distribution of the undistributed profits which have caused the reduction.

COMMISSIONER GRANT: What do you think, Mr. Anderson, the effect of such a plan might have on a company which was small and the shares were controlled, vested pretty much in one person. He might not have majority control but he would have virtual control. Might he use his company as a means of storing up a fund which he could take out as it suited his purpose, say in later life.

He might be on a high salary at the present time and he might say I don't want this income now but when I retire and my salary drops or ceases this is when I want it. He might use this to that effect which might be a detriment to the majority shareholders.

MR. ANDERSON: There are problems that occur in cases of non-public companies or closely controlled companies. As I understand it the tax loss today makes certain provisions for the undistributed income in cases of that kind where the income can be deemed to be distributed although it isn't.

THE CHAIRMAN: You are not suggesting we tax undistributed income more than distributed or vice-versa?

MR. ANDERSON: I am suggesting that the income tax levied on undistributed income should be regarded as part of the income tax that is levied on persons, that it should be a similar form to that levied on persons. I am inclined to the view that other taxes paid by corporations which involve any profits that are distributed should be in a form that is not distinguished by whether or not the business is

2 incorporated.

COMMISSIONER PERRY: Specifically do you have in mind continuing taxation on dividends under personal income tax?

MR. ANDERSON: Yes.

COMMISSIONER PERRY: With some sort of credit allowance.

MR. ANDERSON: No.

COMMISSIONER PERRY: No credit?

MR. ANDERSON: I am not in favour of this form of credit.

COMMISSIONER PERRY: I mean in respect of dividends out of undistributed surplus.

MR. ANDERSON: In the case of dividends coming out of undistributed surplus which has already borne tax the assumption is that the corporation in those cases would use the kind of technique that is used in England in grossing up dividends and recovering the tax so that the individual would have taxable income of the gross amount and he would have a tax credit he could take at the level of personal income tax.

COMMISSIONER PERRY: He would still be subject to personal income tax on that income?

MR. ANDERSON: That is right. If it were practical to find a method of levying the tax on undistributed income at the level of the individual shareholder this might be an acceptable answer but I think it is quite impractical.

In that event you wouldn't have any income tax

as such, applying to corporations.

COMMISSIONER PERRY: Sticking with the question of principle here, do you think any adjustment should be made for treating dividend income received by individuals in any different way from any other form of personal income?

MR. ANDERSON: Not from a theoretical point of view, Mr. Perry. In Canada I can see certain practical justifications for making dividend income more attractive to the individual. These pertain particularly to the desire on our part to have greater ownership of Canadian corporations in Canada. In theory I think that the tax laws should be as neutral as possible at the level of the individual as between different sources of income. I don't think the purpose of the tax laws per se should be to nudge the economy in particular directions. Put it the other way round: if there are other justifications for treating certain kinds of income differently from others I think preferably this should be done by explicit amendments to the normal tax laws in the form of either surcharges or subsidies and it would seem to me that this is the kind of thing that could be done at the level of business in respect to indirect tax as well as in the area of income tax as they apply to the individual.

Any kind of action by Government that is for a purpose other than normal purposes and normal taxation should be as explicit as possible.

THE CHAIRMAN: Do you suggest that income arising from corporate activity is not neutral with other

forms of income in our existing system?

MR. ANDERSON: Under the existing system -- well, it has been my observation that under the existing system the function of the corporate income tax and the 20 per cent credits has the effect of achieving neutrality for low income people, and also for extremely high income people. A person in a very high tax bracket is technically better off with this system than having the income all imputed to him. There is still a fairly severe impact on middle income persons, that is where the 20 per cent tax credit doesn't come very close to offsetting the impact of the corporate tax.

It might be argued, of course, that if our system as it stands today has too much progression in it that this method has been used deliberately in order to indirectly remove some of the progression as it exists through the middle incomes or alternatively postpone it so it doesn't have the same impact that would be the case if the taxation of income of shareholders were handled differently. Again I would make the point that I don't care for the process of accomplishing by indirect means something which isn't related to the general purpose of taxation as such. I think it could be accomplished by more direct means.

THE CHAIRMAN: Do you feel there is a lack of neutrality as between distributed and undistributed corporate income?

MR. ANDERSON: It is hard to give an

answer to this except in relation to the general position of shareholders, that is, in other words the kind of marginal rates at which the shareholders in general are taxed. My own views are to the effect that if we arrive at rational conclusions as to the form of the income tax system as it applies to individuals, this would involve a fair amount of cutting of the top brackets, although I don't go as far as some of the advocates of so-called proportional taxation in this connection.

I have the feeling that in the Canadian scene as it exists today the top bracket should be somewhere around 55 per cent. You could achieve neutrality under these conditions by using a tax rate on undistributed corporate income that was equal to that used on income tax for individuals. In other words you would be merely taking the position that this income was being taxed as if it were paid to the people in the top bracket. Remember at the time that the income was distributed this would be adjusted, in other words to the extent that it is eventually paid to people in lower brackets the adjustment would arise through a process of grossing up the distribution together with recovery of the taxes by the corporation which in turn would mean a tax credit to the individual.

THE CHAIRMAN: You are saying in conjunction with that thought that dividends as they apply to individuals should be grossed up, I take it?

MR. ANDERSON: This isn't the important point to my way of thinking in relation to dividends that

are paid out of current earnings of the corporation. I can't see that it makes very much difference whether you levy a tax at a standard rate on corporation profits and allow the corporations to gross up dividends and recover taxes on the distribution, or whether you take the alternative view that whatever they distributed could be regarded as a reduction of the profits.

In other words they would treat dividends in the ordinary course of events in the same form as interest, sir.

COMMISSIONER PERRY: You would retain some sort of a tax on corporate annual profits, would you, or do you have in mind, as some witnesses have suggested that you do away with that altogether, your retained taxes coupled with undistributed profits.

MR. ANDERSON: My feeling is rather strongly to the effect that we could work out a better system by allowing reduction of dividends in the computation of profit.

COMMISSIONER PERRY: On dividends including those going abroad?

MR. ANDERSON: With incomes going abroad. Quite a lot of the difficulty relates itself to the more general problem of income paid by Canadians to outsiders, and correspondingly the problem of income from abroad which is coming to Canadians.

As you are quite well aware, you have two sovereign jurisdictions involved in this problem, and there is some doubt in the minds of different nations as to whether it's the paying country that is entitled to the tax, or the receiving country. I have had the view that there is something wrong with this process as it operates between Canada and other countries. The process, as it exists now, in general, is to the effect that the paying country can within limits collect what it likes and then the receiving country suffers in its revenue because the individual takes credit for the foreign tax deduction. I am rather of the view that internationally we should be thinking about what is tantamount to sharing jurisdictions.

In other words, the paying country should be entitled to recover by withholding half the tax that it would get either at the level of the corporation or at the level of the shareholder, if the money were paid to a resident.

Correspondingly with income received from abroad, I think it would be logical to say that the

credit for tax borne on that income was limited to half the tax that would be paid on it by the Canadian recipient, if the income were received in Canada. This sort of approach would have the effect of arriving at a neutral solution, if you like, to income flows, across the borders.

In effect it says we are claiming half jurisdiction, let the other half rest with the outside countries.

If that pattern were followed under conditions where, for example, the tax on undistributed corporate income were at 55 per cent, this would mean that dividends paid to non-Canadians would suffer withholding tax of 27-1/2 per cent, using this so-called 50/50 approach.

COMMISSIONER PERRY: Just to restate the position: your basic anchor here is that personal income should be subject to the same sort of tax, that is a graduated progressive tax?

MR. ANDERSON: As we have now?

COMMISSIONER PERRY: As we have now?

MR. ANDERSON: Yes.

COMMISSIONER PERRY: With 55 per cent top?

MR. ANDERSON: Well the top rate is subject to independent discussion. That is, I have got views as to how the top rate is determined.

COMMISSIONER PERRY: That is the anchor position?

MR. ANDERSON: That is right.

COMMISSIONER PERRY: But in thinking about that,

thinking about the fact that this is income from corporations and has been taxed at the corporate level, you do contemplate some recognition of this man's personal income? I am putting this rather simply.

MR. ANDERSON: In other words, as I understand the question, if the shareholder of the Canadian corporation is drawing dividends which are paid out of after-tax profits, is he entitled to some recognition at the level of receiving that income? I would say yes.

COMMISSIONER PERRY: It is putting this rather simply because the other position, which has been the trend in recent years, is that you take everything you are going to get at the corporate level. As you know, there are arrangements under which all tax liabilities are settled up at the corporate level.

MR. ANDERSON: As I mentioned earlier, this still is possible to contemplate, the corporate tax being applied prior to deduction of dividends paid and then to have the dividends paid on a gross basis [illegible] dividend to recover the withheld tax as a credit.

THE CHAIRMAN: And of course the third alternative is our existing system where dividends are distributed and tax credits allowed against them?

MR. ANDERSON: Yes.

THE CHAIRMAN: Which is not grossing up?

MR. ANDERSON: No.

THE CHAIRMAN: It is, to some extent, the same thing?

MR. ANDERSON: If the present system were a little more refined in the sense that the tax credits could be graduated, according to the income tax position of the individual, I think it would achieve the same end result.

THE CHAIRMAN: It went through my mind a few minutes ago, when you spoke about it, the effect of the tax credits and I was wondering if that could be cured by some grading. I suppose it could?

MR. ANDERSON: I suppose. The arithmetic is not very difficult to get at the tax credits. In other words, if you want to achieve the effect of abolishing the so-called double taxation, it is possible at every marginal tax bracket level to arrive at the rate of tax credit which is appropriate for that purpose. The major practical difficulty of course is that people that are entitled to have relatively high marginal rates, may go very heavily into equity investment and escape taxes altogether. This is the case now, as I understand, with a retired man and wife who may have a dividend income of over $10,000 a year, and pay no personal income tax at all.

THE CHAIRMAN: What do you think is the fair view of the double taxation on corporate income? My question really is whether or not you considered this corporate income is taxed twice? If corporation tax is borne by the shareholders, I would assume it is taxed twice. If it is borne not by the shareholders but by other people, it would only be taxed once. I would think, normally, when the dividends are

distributed to foreign shareholders, it's taxed once and a half .

MR. ANDERSON: If the economists conclude that some of the corporate tax is exported back to customers or to employees, and I think we all agree with this conclusion, but disagree as to how much, but if that is accepted as one of the intents of corporate income tax, it would be much better to design other taxes that would do this more explicitly.

In other words, it does not seem to me that it makes too much sense to expect corporations to pass some of their taxes back to the customers and to assume that with unincorporated businesses they don't have this problem. It's an illustration of lack of neutrality in the tax system if it occurs, isn't it?

THE CHAIRMAN: I suppose everybody tries to pass on taxes somewhere and if one is taxed in any way at all, surely there is going to be an effort made to do this.

MR. ANDERSON: In this connection I think a case could be established for a fairly limited amount of double taxation as applied to corporate income on the score that the corporation, by virtue of the jurisdiction in which it is created, does enjoy certain privileges that the individual business lacks, and to the extent that it is in a preferred position, it should in effect be licensed, if you like, to enjoy the position which it occupies and reasonably the form of licensing is a rather mild tax on profit because the

amount of profit is, presumably, an indication of the privilege which the corporation enjoys.

THE CHAIRMAN: Well surely that is only a fair statement up to what is a reasonable licence fee?

MR. ANDERSON: That is right.

COMMISSIONER PERRY: You may be familiar with the views that have been presented to us by Mr. Capon of the DuPont Company. He puts great stress in his argument for removing the corporation profits tax, at the same time levying a very heavy tax on undistributed income, onthe desirability, in fact he would say the necessity of achieving much wider ownership of equity and, therefore, much broader participation in the profit-making process. Is this a concern of yours? Is this a subject to which you have given some thought?

MR. ANDERSON: Yes. I have had the general feeling that it is not a good thing for any country to allow its corporations to retain very large amounts of undistributed profits. I don't think any country is going to do it anyway. In other words, the general pattern of taxation around the world has been to the effect that if corporations accumulate large amounts of undistributed profits, that is an indiccation that they are able to pay more taxes so that the tax gatherer himself might be looking at that source of revenue.

From a general economic point of view, it has always seemed to me that the corporation that is

successful, and is doing a good job, has no difficulty at all raising capital in the free capital markets. On the other hand, the corporation that may not be doing a very good job, and may be heading in the direction of stagnation, may be in a position that they cannot raise money too easily and they might find a method of perpetuating their lack of efficiency through the process of generating retained profits.

In other words this, in effect, would give them access to capital without going through the test of the open market judgment.

COMMISSIONER PERRY: We have had some presentations from fairly successful corporations before us who have argued that the ability to retain earnings is the secret of their expansion.

MR. ANDERSON: I think this is all right. I say why not be neutral? Why not tax retained earnings
2 as if they had been distributed and you can exercise your own judgment as to whether or not you are going to retain them or distribute them. This seems to me to be the logical solution from the point of view of the tax law.

THE CHAIRMAN: I don't know how one achieves neutrality between the two. I think you suggested we have not done that now but you say, your last statement was to the effect that we should tax them in the same way we tax distributed earnings?

MR. ANDERSON: Yes.

THE CHAIRMAN: So that the impact of taxation is equal between the two?

MR. ANDERSON: Now I go further and I mention, Mr. Carter, that under conditions where Government wants to depart from normal objectives of taxation, it should do it by the process of an explicit surtax or subsidies.

THE CHAIRMAN: Before you get to that though I wanted to ask if we haven't achieved a neutral position now as between distributed and undistributed corporate profits? Do you suggest that it would be achieved by taxing undistributed profits at the highest rate of personal tax or, as you suggest, perhaps 55 per cent?

MR. ANDERSON: No it was not an alternative suggestion, Mr. Chairman. I suggested that if the personal tax system were rationalized so that its maximum rates were around the 55 per cent level, then I thought that it would be quite logical to tax undistributed profits at the same rate as that maximum, but under conditions where the personal tax rates are running up to very much higher levels, and where it is perfectly obvious that the amount of corporate dividends that are bearing these very high rates is a very small proportion of the totality of corporate dividends, I don't think you could defend, on the grounds of trying to achieve neutrality, using the maximum rate of the personal income tax to tax undistributed profits.

THE CHAIRMAN: Under conditions you ennunciated, on the 55 per cent calculated tax, would you reach neutrality as between distributed and undist-

ributed corporate income, by taxing undistributed income at 55 per cent and letting distributed corporate income fall on whatever the agreed rate might be? That is your suggestion?

MR. ANDERSON: Yes, but the way of working it out might be any one of the three alternatives we mentioned earlier.

THE CHAIRMAN: That puzzles me because where a man's marginal rate is 55 per cent, it would then be of no consequence to him whether he paid that 55 per cent tax rate as an individual or whether the company paid at the same time, because both payments would be at the same time.

MR. ANDERSON: Yes.

THE CHAIRMAN: And he was going to get credit for the company's payment afterwards so that then they would be in balance but ---

MR. ANDERSON: You are worried about the individual who has got a lower marginal rate?

THE CHAIRMAN: Yes, I was and ---

MR. ANDERSON: Well one of the points that is involved there, one of the points developed in this paper is that the lower marginal rates that apply in the lower brackets are predicated upon the presence of consumption function. In other words, as I understand it, the lower marginal rates are implicit in an attempt to levy at the top rate on the portion of the income which is not consumed.

In the case of undistributed profits, it is pretty hard to argue that the individual was eventually

entitled will consume them before he has got them. As long as they stay at the corporation level, they can be regarded as being in the same position as the top bracket personal rates where the consumption function is presumed to be marginally nil.

THE CHAIRMAN: Let us see if we are all with you on this. You are suggesting that every tax-payer would, under the circumstances of a graduated tax be actually paying on his non-consumed income at fifty-five per cent?

MR. ANDERSON: Not his actual non-consumed.

THE CHAIRMAN: On his imputed?

MR. ANDERSON: On his imputed or implicit non-consumed income. I am suggesting not only this, but once the form of the consumption function is agreed upon (and there is one other factor involved in it, that the consumption function as agreed upon must be inflated to the level of incomes but that is a different point that has to do with the incidence of savings across the community) but the consumption function agreed upon inflated to the actual level of income of all people, in effect, is the exemption. In other words, income tax would fall at the standard rate on the individual income less this exemption so calculated. This is a rising exemption, of course, with increasing income but rising at declining marginal rates.

THE CHAIRMAN: I think that brings us perhaps into a discussion of personal tax rates. Starting at the lower end of the scale, under your proposition

it means that to the extent that there is an imputed excess of income over the consumption estimates, as soon as a person starts to pay tax he starts to pay tax on that little bit.

THE CHAIRMAN: Now, what is your rationale of the point at which income taxation starts? Is that the rationale at that particular point?

MR. ANDERSON: Yes, I think so.

THE CHAIRMAN: Could we have it?

MR. ANDERSON: Rationale involves several different things. Perhaps the most impelling of all considerations is the administrative problem; in other words the ridiculousness of trying to apply different amounts of tax to different amounts of low income when the income of people are below some point of administrative feasibility. I don't think it makes any sense to try to levy income taxes on those low incomes that are distinguished by the amount of the income. On other grounds a uniform tax doesn't make sense, since it brings you into the area of poll tax. There quite evidentally is some point below which it is, in my opinion, administratively not feasible to levy income tax. I assume, of course, that an income tax could be levied on a lot of that income.

THE CHAIRMAN: On a lot---?

MR. ANDERSON: On a lot of it through the process of source deduction, but I must confess that I feel very uneasy about a method that applies taxes where the process of collecting is feasible but doesn't apply in like circumstances where the process is not feasible. On this first point there is some lower limit below which, on administrative grounds, it is preferable not to be levying taxes that are based on the amounts of income. Another point that is often

raised is the question of whether or not the income is sufficient to provide subsistence and whether direct tax should be levied below some level commonly agreed to be the minimum that people require. This particular point doesn't appeal to me as important, since we already know that the consumer expenditure of these low income people is bearing a relatively heavy indirect tax context.

Consumer expenditure rises with income. Indirectly the tax is related to the income. The question of when the direct tax starts to emerge seems to me to largely rest on the question of when the consumption function starts to decline markedly. At the juncture where the marginal consumption has fallen and you fail to start to levy a direct tax the total system is regressive, so that it is important to bring direct taxes in to parallel the rate at which the consumption has fallen, in order to get a combined system such that the marginal combined rates for indirect and direct taxes are approximately proportionate to income.

The exact point at which the tax should emerge -- I have given a great deal of study to this, Mr. Chairman. I don't know whether I can express the exact point because this would be by algebra, but the exact point is when the income is such that people immediately above it...

THE CHAIRMAN: Have you this written down?

MR. ANDERSON: No, I will supply it later on. It is the point at which the people immediately above

that point, if you count them on up cover 50 per cent of the population up to the upper income limit that is equal to the mid-point between the median income of the population and the average of the upper half. If you like me to do it I could give you a short memorandum covering some of the views I hold about this point.

I think I might express it rather briefly subject to two fundamental assumptions, the first one that you are living in a democratic community where everybody is entitled to have a set of opinions and the second one that unfortunately everyone is selfish and will have a set of opinions that maximizes his position in the community. A study of the sets of opinions that everybody in the community would have as to the form of the consumption function -- would indicate that each person would feel that the consumption function would be a constant marginal rate up to his income and a zero marginal rate thereafter.

If you put these things together and take the array of opinion that emerges you can now determine for each individual a particular consumption function that is such that half of the people in the community think it should be bigger and the other half think it should be smaller. This is a stable position. What you discover is there are two points, turning points in this array, the lower turning point in the array is the one where the individual has income that is mid-way between the median income and the average of the lower half. The upper turning point is the one I

mentioned earlier where the individual has income that is mid-way between the median and the average of the upper half. With people outside these turning points the stable consumption function is dictated by the consumption function opinions held by the people of median income. Within the turning points this isn't true. The people through the middle are not stable in that position. They don't rise to the point that the median income opinion indicates.

This means the stable consumption function goes through the middle, incomes between the turning points in a manner where all of the aggregate consumption has not been used in determining the stable set of opinions.

Now, the question arises where the remainder is to be placed. Here you have to get into an exercise of the different kinds of majority that might be assembled in Canada in order to force this remainder into one area of the consumption function. What happens after you examine the possible majorities is that you discover (and this is part of the theory of Von Neuman and Morganstern -- that stability through the whole community involves foregoing something that you get possibly in order to avoid losing something that you are not sure of.

The distribution of this remainder though the middle is in the position where you wind up with a six-bracket system. You have a system where the first point at which progression applies is the point where 50 per cent of the people are between it and the upper turning point. Corresponding to the last point is the

point that has 50 per cent of the people between it and a lower turning point and the middle or median income becomes the middle point in the brackets.

It looks as if in Canada the number of people in each of the brackets would be more or less equal. By definition -- the number of people in each three successive brackets, these brackets being one, two, three; two, three, four; three, four, five; four, five, six -- is equal to half the population. It also looks as if, from the work I have been able to do that the marginal consumption function would move approximately in equal steps as you went up the steps.

The first brackets would involve no tax. It would drop by one-fifth in the second, two-fifths, in the third and so on. In conditions where the marginal consumption function is at the bottom, say seventy-five per cent, it would drop to sixty, forty-five, thirty, fifteen, zero.

THE CHAIRMAN: Does that mean our graduation is about correct?

MR. ANDERSON: It means in general our graduation is not too bad. We have too many brackets. That is one problem. It looks as if we are too high at the top, at the extreme top. As far as I can tell through the middle the general pattern of the system we have now seems to be not too far off the mark. All this, of course, Mr. Chairman, relates to our system of income splitting. In other words if everybody were single I think I could argue that our present system is pretty good. Unfortunately they are not all single.

COMMISSIONER WALLS: I wonder, Mr. Anderson, when you give us your memorandum, if you are going to give us one, it would be possible for you to give us a hypothetical example? I think we could follow it much better if we had it.

MR. ANDERSON: It makes no sense to try to look at the thing without an example.

COMMISSIONER PERRY: This poin t determines the level of personal exemptions.

COMMISSIONER WALLS: I was just getting back to your question first. Putting it more directly have you been able to test the present level of personal exemptions by applying the theories you just expounded?

MR. ANDERSON: Well, I have tried to test the principle, but part of the theory involves the question of the amount you have in the area of the income security payments. Remember that under conditions where income security payments may be at different levels for different people the level of personal exemptions can in part be used as a substitute for income security payments.

In other words if we had a system in Canada, and I am sure you remember this, Mr. Perry, where the baby bonus applied to everybody we would probably have a different level of exemptions along with this system in the same way as at the present time we use a different level of exemptions for the allowance child as compared to the non-allowance child. I don't think I would be prepared to try to give an answer as to the

appropriateness of the present level.

I will make this point: going back to my first comment about the administrative problem, I have some doubt as to whether our exemptions today are at the right point. I think single people, at least should probably be a little higher because when I look at the taxation statistics I find in the $1,100 to $1,200 bracket that we collect an average of about $9.00 per taxpayer. In order to get this from around sixty thousand taxpayers we have to examine one hundred thousand returns in that bracket. I am extremely doubtful that the Income Tax Department operates on a basis where its' costs are much lower than $9.00 per return. It is from a practical point of view that I think it could be argued that the present exemption level is just a little too low to be productive and of course, as you know it would be perfectly practical to increase the basic exemption level slightly and compensate for that by a mild alteration on the low bracket rates.

COMMISSION PERRY: It is an interesting thought, though the Americans have a level that is considerably lower again.

MR. ANDERSON: Yes, but remember the American exemption, the $600.00 figure is applying to children.

COMMISSIONER PERRY: For families, yes. I was thinking of single persons.

MR. ANDERSON: There is also an effect through the process of granting earned income relief.

THE CHAIRMAN: We are all rather anxious here I think to associate income tax levels with grants and other forms of payment. Is there any means by which grants be replaced by income tax exemptions or graduations of tax? I suppose graduation of tax doesn't make an awful lot of sense because it would take very substantial grants to look after that. It may be we should tax, as you suggest, most grants as you say in your paper, or we should arrange something instead of grants.

MR. ANDERSON: So you don't need to bother taxing. I have expressed myself pretty strongly in this area.

THE CHAIRMAN: You have indeed.

MR. ANDERSON: Under conditions where the transfer payments come from a variety of programmes and where they cannot be considered as rationally related one to the other, it seems to me that equity is much better achieved if all these grants from the Government are regarded as income for tax purposes. I think we have started tht process now in the case of the old-age security payments. It doesn't produce much revenue. As far as I know the marginal tax recovered from taxation of old-age security payments wouldn't be more than $10 million a year.

2 One and one half per cent of the total benefits are recovered through application of marginal tax rates on old-age security payments and yet I have very strong feelings that those payments, being taxable, have made the programme considerably more acceptable throughout the community.

Under conditions where the old-age security payments were free of tax, I think there would be a very much stronger feeling that the whole programme go through the administrative agony, if you like, of denying the old-age security benefits to higher income people.

THE CHAIRMAN: Would that be difficult to do?

MR. ANDERSON: I have the feeling it would cost more than you would save.

THE CHAIRMAN: If one used income tax returns as the means test and then imposed a hundred per cent tax on these things in excess of a certain level of income?

MR. ANDERSON: I suppose you could do it. There again, if we pay any attention to the problem of the rather smooth progression of the marginal rates that seems to me to be desirable in the interests of equity, I think you would have to be careful about using that one hundred per cent tax beyond a certain point.

In this same area, Mr. Chairman, perhaps it in part answers your question, I do not see any sense in granting the extra $500.00 exemption at the age of 65, if persons are also entitled to income security benefits, although it seems to me that it may be defensible for people

that aren't entitled to.

I am on the record 12 years ago at a Parliamentary hearing to the effect that not only should the old-age security payments be taxed, but also any special exemption for age should be denied, so that the denial of that exemption would meet your point in particular. It would mean, as a consequence of getting old-age security, not only do you pay the tax on it, but also pay taxes on another $500 of your income.

If you look at another problem, and that is family allowances, the method we are now using on reducing the exemption in consequence of the child being eligible for family allowance does not, to my way of thinking, represent a very neat or satisfactory solution to the problem. We have driven ourselves into the position now where some of our highest income people are, in effect, paying taxes on more than 100 per cent on the family allowance in their families.

Now I would think it would be much more satisfactory to regard family allowances as being taxable income and to have whatever exemption for dependents there are on a basis where they were independent of the question of whether they are eligible for allowance or not. I think there are two reasons why we did not do it this way. Perhaps your colleague, Mr. Perry, will recall that one was, at the political level. There was a promise made not to tax the family allowance. The other point was that since the system pays the allowance to the mother rather than

the father, that our tax laws in many instances would fail to pick up the taxes on the allowance if they were made taxable.

On the other hand, if we are going to move in the direction of income splitting, now it would be quite feasible to include the family allowances in the income that was subject to splitting before tax calculation.

Take another area ---

COMMISSIONER PERRY: Just before you leave that. The most immediate and practical reason for this change in the income tax allowance was that the Family Allowance Act requires that it be done that way.

MR. ANDERSON: That the exemption of dependents ---

COMMISSIONER PERRY: It was recognition of the fact, under the Income Tax Act, that the family allowance has been paid on the same child.

MR. ANDERSON: I am not quite clear on the point.

COMMISSIONER PERRY: This was a Statute that had been passed by Parliament that this adjustment by made.

MR. ANDERSON: Oh I see.

COMMISSIONER PERRY: That was the reason that was done.

MR. ANDERSON: In other words, the reduction on the exemption is due to the fact that the Family Allowance Act by cross-reference requires it?

COMMISSIONER PERRY: Contemplates this sort

of adjustment.

MR. ANDERSON: There is nothing in the Family Allowance Act that says explicitly that the allowances are not included in taxable income.

COMMISSIONER PERRY: No, I don't suppose there is. I think this presents a different sort of magnitude than the concept of old-age pensions taxation. I am not quite prepared to argue this through at the present time because I have been wondering for at least 15 years what the right system should be but this means that a lot of those what you may regard as otherwise low income people would come into the tax net and I can appreciate the theoretical arguments for this.

In other words, I think you would arouse, to a much greater extent, a feeling that the Government is giving with one hand and taking away with the other and that this is a rather asinine exercise to be engaged in on a large scale.

COMMISSIONER WALLS: I think this is, by the same token, why you tax unemployment insurance and workmen's compensation?

MR. ANDERSON: Yes. I was coming to the question of unemployment insurance. In this particular area it has been apparent over the years that it is difficult to determine appropriate rates for unemployment insurance, ones that will not encourage idleness, and so on, under conditions where the unemployment insurance benefit is not taxed, whereas the wage is. That is, in other words, you are comparing like and unlike on whatever the set rate is. It has certain further facets in

the case of unemployment insurance.

The recognition of unemployment insurance as taxable income would mean that the individual who is unemployed for a short period would be paying a fairly high marginal rate of tax on his unemployment insurance benefits, which would be added to other income he had during the year. Whereas, the individual who suffered a long-term unemployment would, presumably, have total income, including his unemployment, that was below his exemption level and would be paying no tax at all. It has the further advantage in the case where a system may be subject to abuse, such as with seasonal benefits, that the inclusion of unemployment insurance in income for tax purposes would furnish a method of bringing this whole problem to the surface, because people who are drawing unemployment insurance for a season under conditions where they had high seasonal pay, would be subject to a comparatively high marginal tax rate on it.

Furthermore, the ability to analyse this whole problem through unemployment insurance being joined together on the tax return with other income would, I think, lead to better solutions.

With workmen's compensation, there is a somewhat different problem, Mr. Walls. This is the fact that it is a mixture of indemnities, for loss.

COMMISSIONER WALLS: Can't you also have the situation, exactly the same situation as a man would have a relatively high salary.

MR. ANDERSON: That is right. It is quite acute now in workmen's compensation with rates of 75 per cent of the wages, up to the specified Provincial limits. There are cases in the workmen's compensation field where it is pretty hard to argue that the individual is not better off than he was otherwise, so that I would not be worried at all about extending taxation into the workmen's compensation field.

There is another area that has not become important in Canada, but it may at some stage: the whole area of cash sickness benefits. Here you have the situation today in Canada where employees that are paid sick leave, civil servants, for example, are being taxed on that pay. Whereas, employees of business that use weekly indemnity insurance are free of taxes.

Again, this does not involve payments from Government, as such. The developments in the United States are rather interesting because there, of course, they have certain States that are providing cash sickness benefits through Government funds and, as well as that, the Railroad Retirment Board provides them for railway workers. The pattern that is applied there now is that it has been more or less a matter of compromise, if you like, that benefits paid in the event of illness to the wage earner, whether they are paid through sickness leave or through insurance contracts, have been exempt up to the level of $100.00 a week and taxable beyond that.

On their new tax bill they are proposing to

to deny this $100.00 a week exemption during the first 30 days of illness, so that it will not come into play until the end of that time.

In other words, I think that the thinking there has been very powerfully in the direction that their sickness benefits, no matter how paid, whether paid as paid sick-leave, paid by private carrier, paid by Government funds are, in all cases, to be regarded as income for tax purposes.

COMMISSIONER PERRY: You argue for all these things on the basis of equitable treatment, I should think.

MR. ANDERSON: It is not altogether equitable treatment. I have the feeling that the problem of setting appropriate rates of benefits is much more easily solved under conditions where the dollar of benefit are the same kind of dollars as the dollars of wages.

Mind you, in theory I would carry this through to the means test benefits, although in those cases it might be argued that applying the theory is unwise, firstly, because a great majority of the people that get benefits of that kind are not taxable anyway and, secondly, because the process of taxing benefits would require, in turn, a process of including taxes in budgets. My inclination, on the grounds of practicality, is not to extend the taxable position to benefits that are determined by the individual circumstances of the recipient, either on the means test or means test basis.

COMMISSIONER PERRY: I think where some of

these programmes call for employee contribution would indicate you would have to allow this contribution as a deduction from personal income.

MR. ANDERSON: I think you would, if you are going to follow the pattern that benefits are taxable.

COMMISSIONER PERRY: This would probably be a revenue losing process, by means of this unemployment insurance, for example.

MR. ANDERSON: Workmen's compensation you are entitled to where you have non-contribution.

COMMISSIONER PERRY: I am thinking of where an employee contributes.

MR. ANDERSON: In the case of unemployment insurance, this would be revenue losing.

COMMISSIONER PERRY: To the amount of the deductions being taken. There are only relatively few people who are taxable and unemployed. This is an irrelevancy from the position you are taking.

MR. ANDERSON: I want to pursue it a bit. I have a feeling that it is a little awkward in this day and age to grant distinctions in tax positions on employee benefit programmes by reasonof the fact that the contribution is split one way or the other.

In other words, if the programme is essentially one of providing employee benefits, by what rationale do you arrive at the conclusion that if the employer pays for all, it should be taxable but if he asks his employees to contribute, that their share of the contribution is not deductible? If he wants, he can in fact make them deductible by the process

by reducing his employee's pay, rather than making deductions from it.

COMMISSIONER PERRY: I would think an employee would prefer to have the fringe benefit taken into income rather than be taxable on the cash received because the total annual unemployment premium, for example, paid by the employer is not very large.

MR. ANDERSON: Well because it is split equally; I believe one per cent of the taxable ---

COMMISSIONER PERRY: Yes. If you include this in the income of the year, you wouldn't pay much of a penalty compared in some cases to being taxable on unemployment insurance receipts.

MR. ANDERSON: In other words, a lot of people prefer what we are doing now?

COMMISSIONER PERRY: I think if it were the choice of being taxable on the receipts or it being taxable onthe employer's part paid in each year, then they might prefer that second alternative because the amount of tax would not be very large.

MR. ANDERSON: You are suggesting here that the employer's share be regarded as additional income to the employee and report them together?

COMMISSIONER PERRY: If there were a choice, the employee might say I prefer to pay tax onthe employer's part.

MR. ANDERSON: Incidentally, there is one method that quite a few employers use on unemployment insurance, where they just pay the whole thing. You see, under unemployment insurance the tax is levied,

in the first instance, on the employer and he is given a statutory right-of-recovery of the employee's portion but if he does not exact that right of recovery, he charges the whole thing as an expense and he can reconvert the tax into a non-contributory system, as it stands now.

COMMISSIONER PERRY: How far do we respect your statement you don't want to discuss insurance matters in this presentation because you are verging on several things that are quite relevant to insurance here, pension plans.

MR. ANDERSON: I don't mind discussing the obvious parallelism between private insurance and public income security. I am prepared to discuss that but I ask not to discuss taxation as it affects life insurance.

I think, if you want to have views on this subject, that it would be more satisfactory to get them through the regular channels, as it were, because I understand there is some possiblity you may do this.

COMMISSIONER PERRY: Then just going back to unemployment insurance and workmen's compensation, there was a vague assimilation of these kinds of payments through the treatment of ordinary insurance. As you know, general indemnification insurance is not taxable. These public measures were assimilated to the private sector. I am not suggesting that one might not change and one might not have implications in the other.

I think there is a principle at work here in the present treatment.

MR. ANDERSON: I think I might answer in this way: that under conditions where a public insurance system is being run on what is tantamount to private lines, (and this would be true of workmen's compensation. Workmen's compensation funds in Canada are operated just about the same way as if they were private funds.)

Under these conditions, there is every reason for taking the view that we have got to treat them the same as if they were private insurance bodies or, alternatively, we have got to treat the private insurance bodies the same as we treat them.

In the case of a public system that can only very loosely be called insurance, the systems which consist, on the one hand, of the process of raising taxes, and on the other hand the process of dealing with benefits, with comparatively little connection between the benefits structure and the taxing structure, it seems to me that it is better to regard the two things as being separate entities: the revenue-raising side and the benefit structure. However the revenue is raised, it should be regarded as a tax and it should be treated appropriately, having no regard to the purpose for which it was raised. For example, old-age security, pension.

As it occurs now, we don't treat any of those pieces of revenue as being deductible in the ordinary sense. On the other hand, if we move over to the system of payroll financing, as it has been suggested for part of the programme, it is already indicated that this payroll tax would be regarded as being deductible

at both levels: employer and employee and I have got the feeling that since these public systems, that rather depart from individual equity principles, are largely governed by political opinions as to the adequacy of the benefit structures when benefits are paid, that the question of whether the benefits should be taxed or not is a question that should be settled quite independently of the way the system is financed.

Correspondingly, the question of whether the explicit contributions, if there are any, should be deductible for the purpose of general income tax, is a question which should be settled on its own merits quite independently of what is going to happen to those contributions in the course of time. My views are strong in this area. I accept the rationalization of the thing politically. I don't think it is essential, by any means, that you have to exempt contributions because you tax benefits.

COMMISSIONER PERRY: No, I don't think you do either but it does seem to have been a practice sanctioned by custom.

MR. ANDERSON: In this, again, Mr. Chairman, it is rather interesting to look at the Americans in the field of social security where it has developed. The social security benefits under OASDI. are all tax-free. They are grants to individuals. On the other hand the employer contributions, of course, are deductible but not employee contributions. This has developed into a most inconsistent situation because at the level of the Railway Retirement Board the total benefits are tax-free although they involve very substantial benefits.

On the other hand at the level of the civil service, (excluded from OASDI) the total of the pensions are taxable. Here you have a very awkward and conflicting pattern arising in the United States by reason of the failure to treat all of these benefits as taxable income.

COMMISSIONER PERRY: I agree with some of this, but the major operation which I quite frankly find difficult to see, putting it into the reverse, is the family allowance payment scheme where you are recovering amounts of $100 million of a $700 or $800 million total. I know the arithmetic shouldn't matter but it does seem to me...

MR. ANDERSON: Not looking at recovery as such -- I have made some attempts to examine the tax position of families with family allowance to try to see if it is possible in the aggregate to estimate how much of the family allowances are in fact offset by income tax paid by these same families. As far as I know close to half the allowances are now being paid to families whose income taxes exceed the allowance.

Of course there would be another block where income tax would still be present but would be less than the allowances.

THE CHAIRMAN: So there would be very substantial recovery?

MR. ANDERSON: No, recovery wouldn't come through taxation of the allowance. It would come because you can't visualize taxing the allowance without alterating the exemptions.

THE CHAIRMAN: No.

MR. ANDERSON: If you are going to give people an additional $250.00 exemption for each child and at the same time tax the allowance I am rather doubtful that the recoveries would be very much at all. I think Mr. Perry's point was if you merely tax the allowance leaving everything else unchanged you would recover something in the order of $120, $130 million.

THE CHAIRMAN: You can't conceive of doing that.

MR. ANDERSON: It doesn't seem very logical.

COMMISSIONER PERRY: That is true.

MR. ANDERSON: Except in the illustration I have given with the old-age exemption, you would be allowed something because you are 65 but denied it when you start getting old-age security. I am sorry to labour this point on the family allowances but I think it is something you should give a fair amount of attention to because of the possibility that this family allowance system

may be stretched up to a higher age. If you start getting th up to age eighteen with children at school and probably with higher amounts the need to make them fit into the tax system seems to me to be greater than would be the case with the system as it now exists.

COMMISSIONER PERRY: This is one Federal programme which is rather in an untidy situation. I think it is pretty obvious.

MR. ANDERSON: It may be untidy, but it has great administrative success.

COMMISSIONER PERRY: It has gone along very well.

MR. ANDERSON: It is the most efficient thing the Government in Canada has done.

COMMISSIONER PERRY: I am not suggesting there is anything lacking in the way in which they pour out the cheques.

THE CHAIRMAN: This has been very interesting up to now. You, I think indicated a little earlier that direct taxation and taxation on undistributed corporate income was perhaps appropriately used for redistribution of income.

MR. ANDERSON: That is right.

THE CHAIRMAN: Therefore leaving the raising of funds for Government expenditures chiefly to indirect taxes, commodity taxes -- what else would there be -- nothing else, commodity taxes.

MR. ANDERSON: Well, I am not excluding taxes on services in the business community. In other words the indirect taxes are taxes on production, if you like.

The rationae, as I see it is that if the income of the personal sector was satisfactorily distributed the most efficient method for the Government to raise revenue to pay for goods and services is to take as even a slice, as it can off production, as it occurs because after all what the Government is doing is providing goods and services and saying to people, these are things we are going to provide for you rather than letting you do it yourself.

THE CHAIRMAN: You have no objection to that form of money raising being regressive?

MR. ANDERSON: Of course, I would object if it were regressive in relation to personal consumer expenditures. That is like taxing salt alone and my own feeling is that as far as possible those taxes should be made proportional to consumer expenditures, that is as they come out at the level of the individual indirect taxes should be as far as possible proportional to the amount he spends. I feel that at the level of the business system attempts to make indirect taxes progressive with relation to consumer expenditure in order to avoid them being regressive in relation to income, has an effect of producing distortion in the business sector, that in the long run is unsatisfactory. The process of sales tax exemption for food is designedly for the purpose of trying to make sales tax a little progressive in relation to consumer expenditure and therefore less regressive in relation to income.

This is also true through exemptions on services. Rent bulks very largely among services and

rent is regressive within consumer expenditures just as food is, and isn't subject to sales tax. With proper progressivity indirect taxes it would make more sense to say that the indirect tax is designed to take from the individual when he enters into consumer expenditures.

The Government slice out of production which is required in order to provide services or products to the community.

THE CHAIRMAN: To attempt to provide progressivity or to tax something with social taxes of some kind is in the area of principle -- when do you get to income tax?

MR. ANDERSON: Income tax and income security payments are what in my mind represent the positive and negative components of redistribution. To put this another way round, you could say that, one of the purposes of redistribution is to permit the business system to function in such a way that it is satisfactory for the Government to take its slice out of gross production.

THE CHAIRMSN: Gross--?

MR. ANDERSON: Gross production as it occurs. I am speaking of the concept of indirect taxes, called the value-added tax. This is a tax at a uniform rate on business entities on the difference between their domestic sales and then tax paid purchases, which

as I understand it, has the effect of bringing up the level of final demand a common value added tax component that is quite neutral as between different goods and services that are delivered to the community.

THE CHAIRMAN: Yes. I think at this point production and consumption are the same, are they not?

MR. ANDERSON: With the exception of some of the capital expenditure this is true. If you are using value added tax at the business level theoretically the capital expenditure of the business concern should be recorded as tax-paid purchases and there should be immediate recovery of the value added tax. I think in countries that use it they find this a little impractical and the more common process is to treat the allowable depreciation as actually taken as being offset against the value added tax base. On the other side if you have satisfactory treatment of the capital expenditures for business worked out, then, of course the value added at the level of business, is approximate to the expenditures by both consumers and Government on goods and services remembering, of course, that the value added by the business sector includes value added by Government, but only on the service level.

The Government expenditures on goods is not handled that way, naturally not.

THE CHAIRMAN: Indirect taxes being roughly equal to the services provided by Government -- would that apply to all levels of Government?

MR. ANDERSON: Assuming that Government is

breaking even, that is leaving aside for a moment whether it is running a surplus or a deficit the aggregate of the indirect tax should be the same as the Government expenditures on goods and services plus the Government subsidies to producers, plus its so-called institutional grants (in other words the transfer payments that are going out to private non-profit bodies that are in fact acting as instruments of Government and providing services to the community) less profits of Government business enterprises -- according to the theory as I see it the question of the position of Government capital expenditure and the question of interest on the public debt causes some doubt as to whether its costs should be covered within the indirect tax system and also the incidence with which these things should be covered, remembering that Government capital expenditure is treated just as if it were current expenditure.

THE CHAIRMAN: That is only a matter of time, is it not?

MR. ANDERSON: Yes, in the long run they should be in there, but it is a question of whether the incidence should be exactly that way. Again I think that problem is related back to the question of the treatment of capital expenditure of business, and this might effect the way in which the capital expenditure of Government is covered under such a system.

COMMISSIONER PERRY: I was just wondering on this particular point, you refer to this as "the" theory?

MR. ANDERSON: According to this theory.

COMMISSIONER PERRY: I was just wondering whether it is a theory you have found in other writings?

MR. ANDERSON: No, I must confess that I haven't seen this particular train of thought advanced elsewhere. Some of the British writings have come fairly close to it. You may recall that back some years ago the theory of the linking up of the direct tax and the income security payments was proposed, I think it is about 20 years ago when the proposal came forward. It was prior to the adoption of the Beveridge proposals.

It was advanced on the score that it would be possible to consolidate personal exemptions and transfer payments in such a fashion that a simplified income tax system could be used together with transfer payments.

One of the things that that study didn't attack, nor did the Royal Commission on Taxation of Profits and Income was the degree of progressivity in the direct tax system in relation to the consumption function and that is important, consider the indirect taxes, that, of course, are falling marginally as income rises.

I have tried to bring into my thinking, the point that the most rational and logical argument for progressivity is one that hypothesizes the existence of a consumption function that declin es marginally with increasing income. I have also made the point in the paper, and a point which I think is highly important in a political sense, that as long as you have a community with a mass middle majority

you are going to have progressive taxes. You are going to be raising marginally the rate of direct taxes because of the fact that the mass middle majority can keep themselves in a better position in the community that way than with any method that does not involve progression.

THE CHAIRMAN: You have given us a most interesting time indeed.

MR. ANDERSON: It is very good of you, Mr. Chairman. I have found it very interesting also.

THE CHAIRMAN: It stirred us up. There is no doubt about it. I hope that you will advance your interesting theory that you put to us because it seems to me it would be a very valuable contribution to all spheres of taxation. If you have anything further along this line -- I mentioned one matter where you are going to be good enough to send us a memorandum or illustration of the point -- we would be delighted to have it indeed.

I express our sincere appreciation to you for your appearance here today. I thank you very much. It is very kind of you to respond to our request. Thank you very much indeed.

MR. ANDERSON: I do appreciate the opportunity of appearing. Again I would like to apologize for not having been able to bring some of this work more clearly before you.. As you will understand I have had my attention very closely directed to certain things that happened along the "Street" in the last few months. This has prevented me from doing some of the work I would like to have done before this hearing.

THE SECRETARY: I have one brief to enter into

the record. This is a brief from Professor George M. Brownell of Winnipeg Manitoba. This will be Exhibit 247.

---EXHIBIT NO. 247: Submission of Professor George M. Brownell.

THE CHAIRMAN: We will stand over until tomorrow morning at 9:30.

---WHEREUPON THE HEARING ADJOURNED UNTIL 9:30 A.M., THURSDAY, THE 7th DAY OF NOVEMBER, 1963.

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